

This Listing Statement is compiled by the Exchange from documents filed by the Company in making application for listing. It is issued for the information of members, member firms and member corporations of the Exchange. It is not and is not to be construed as a prospectus. The Exchange has received no consideration in connection with the issue of this Listing Statement other than the customary listing fee. The documents referred to above are open for inspection at the general office of the Exchange.

LISTING STATEMENT No. 2305

LISTED JULY 2nd, 1968

15,000,000 common shares, par value \$1.00

Stock symbol "RVO"

Dial quotation No. 1377

Post section 11

THE TORONTO STOCK EXCHANGE

LISTING STATEMENT

RESERVE OIL AND GAS COMPANY

Incorporated under Chapter II of the General Corporation Law of August 14, 1931, ch. 862, sec. 292, (1931) Cal. Laws 1762 at 1768, by filing and indorsing of the Articles of Incorporation by the Secretary of State of California on March 16, 1932.

1. Address of the Company's Head Office and of any other offices:

The address of the Company's Head Office is at 550 South Flower Street, Los Angeles, California 90017. The address of the Company's Mid-Continent Operations is at 1700 Fidelity Union Tower, Dallas, Texas 75202.

The address of the Company's Accounting Office is P.O. Box 1, Apple Valley, California 92307. The address of the Company's Canadian Operations is 630 Sixth Avenue, S.W., Calgary, Alberta, Canada.

2. Officers of the Company:

OFFICE HELD	NAME	ADDRESS	OCCUPATION
Chairman of the Board	Newton T. Bass	20572 Rancherias Ranch Rd. Apple Valley, California 92307	Executive
President and Chief Executive Officer	John R. McMillan	1025 Hillside Terrace Pasadena, California 91105	Executive
Vice-President	Walter E. Cramer, Jr.	21431 Highway 18 Apple Valley, California 92307	Executive
Vice-President and Secretary	Harold F. Green	5710 Scotwood Drive Palos Verdes Peninsula California 90274	Executive
Vice-President	Paul D. Meadows	4228 Hallmark Drive Dallas, Texas 75229	Executive
Treasurer	Robert E. Aberley	14350 Chinook Road Apple Valley, California 92307	Accountant

3. Directors of the Company:

NAME	ADDRESS	OCCUPATION
Newton T. Bass	20572 Rancherias Ranch Road Apple Valley, California 92307	Executive
John R. McMillan	1025 Hillside Terrace Pasadena, California 91105	Executive
Joseph A. Ball	4281 Country Club Drive Long Beach, California 90807	Attorney-at-Law

Llewellyn Bixby, Jr.	45 Dana Place Long Beach, California 90803	Executive
Walter E. Cramer, Jr.	21431 Highway 18 Apple Valley, California 92307	Executive
Marco F. Hellman	3515 Pacific Avenue San Francisco, California 94118	Investment Banker
Clinton LaTourrette	710 North Rodeo Drive Beverly Hills, California 90210	Financial Consultant
Howard C. Pyle	1050 Glen Oaks Pasadena, California 91105	Petroleum Investor
B. J. Westlund	668 McVey, No. 30 Lake Oswego, Oregon 93074	Retired

4. Names and addresses of all transfer agents:
 Guaranty Trust Company of Canada, 311 Eighth Avenue West, Calgary, Alberta, Canada.
 Guaranty Trust Company of Canada, 88 University Avenue, Toronto, Ontario, Canada.
 Crocker-Citizens National Bank, 611 West 6th Street, Los Angeles, California.
 The Chase Manhattan Bank, (National Association), One Chase Manhattan Plaza, New York, New York.
5. Particulars of any fee charged upon transfer other than customary government taxes: 60c per certificate.
6. Names and addresses of all registrars:
 Guaranty Trust Company of Canada, 311 Eighth Avenue West, Calgary, Alberta, Canada.
 Guaranty Trust Company of Canada, 88 University Avenue, Toronto, Ontario, Canada.
 Security Pacific National Bank, 124 West Fourth Street, Los Angeles, California.
 First National City Bank, 55 Wall Street, New York, New York.
7. Amount of authorized capital: \$25,000,000.
8. Number of shares and par value:
 15,000,000 common shares, par value \$ 1.00
 400,000 preferred shares, par value \$25.00
 designated as follows:
 32,000 5½% Cumulative Convertible (Voting) Series A
 108,489 5½% Cumulative Convertible (Voting) Series B
 259,511 5½% Cumulative Convertible (Voting) Undesignated
9. Full details of all shares issued in payment for properties or for any other assets other than cash: (within the preceding four years)

Date	Number of Shares	Brief description of properties or other assets and the aggregate consideration therefor, expressed in cash, shares, etc.
June 10, 1968	2,668,257 common	Upon completion of the Agreement and Plan of Compromise and Reorganization with Fargo Oils Ltd. (for details see pages 1, 5-8 and (1) to (7) of attached Proxy Statement), all of the shares of Fargo Oils Ltd. whose assets consist of oil and gas properties, see description on pages 34 to 39 of the attached Proxy Statement.
April, 1966	2,500,326 common and 63,750 preferred, Series B	Acquisition of the assets of Apple Valley Building and Development Company, mainly consisting of acreage.
March, 1966	338,028 common and 44,739 preferred, Series B	Acquisition of the assets of Long Beach Dock and Terminal Company, mainly consisting of oil properties, warehouses and dockage facilities in and near Long Beach, California.
May, 1965	215,000 common and 32,000 preferred, Series A	Acquisition of substantially all of the assets of Rice Ranch Oil Company, mainly consisting of undeveloped as well as oil and gas producing land in the State of California.
April, 1964	172,640 common	Acquisition of substantially all of the assets of Fremont Valley Lands, Inc., mainly consisting of purchase money promissory notes and also of certain oil and gas producing leases in the State of Texas.

Totals: 5,894,251 common Shares
 32,000 preferred Shares, Series A
 108,489 preferred Shares, Series B

10. Full details of all shares sold for cash.	All sales for cash to date are shown on attached List of Common Stock Issued, marked Exhibit 1 to this Listing Application. There have been no sales for cash since December 6, 1948, other than sales of shares to key employees of the Company upon the exercise of stock options, see pages 31, 32, 55 (note 11 to Financial Statements) and 3-5 of the attached Proxy Statement, see Exhibit 2 to this Listing Application. (Exhibits 1 and 2 are on pages 9 and 10.)
11. Total number of shares issued:	7,379,465 common shares 27,087 preferred shares, Series A 107,116 preferred shares, Series B (all as at June 10, 1968)
12. Number of shares unissued:	7,620,535 common shares 259,511 undesignated preferred shares
13. Particulars of any issued shares repurchased and held in the treasury of the Company.	As to 2,729 common and 1,554 preferred, Series B These shares came to the Company through the acquisition of the assets of Apple Valley Building and Development Company. Certain shareholders in Apple Valley Building and Development Company had the option to dissent from the reorganization plan and take a cash preference. Those shares reserved for the share exchange not used for the dissenters were reacquired by Reserve Oil and Gas Company as treasury shares. As to 17,658 common and 881 preferred, Series B One of the subsidiaries of Apple Valley Building and Development Company was Richland Oil Company. It held Apple Valley Building and Development Company stock which was exchanged for the Company's stock. Upon dissolution of Richland Oil Company the shares were reacquired by the Company as treasury shares.
14. Date of last annual meeting.	April 25, 1968.
15. Date of last report to shareholders.	March 8, 1968, being the attached Proxy Statement.
16. Details of any unissued shares (or shares issued subject to payment or shares held for the benefit of the treasury) now under option or the subject of any underwriting or sales agreement. If none, this to be stated.	The only unissued shares now under option or subject to conversion privileges are common shares of the Company, and the following common shares have been reserved for the following options, conversions or exchanges. 73,229 for conversion of preferred shares, Series A 261,703 for conversion of preferred shares, Series B 71,650 for exercise of stock options under the Selected Employees' Stock Option Plan — 1964 100,000 for exercise of stock options under the Selected Employees' Stock Option Plan — 1968 903,656 for conversion of the Company's Debentures 3,186 under the stock purchase plan for employees of Fargo Oils Ltd., see pages 40-41 and 7 of the attached Proxy Statement 1,413,424 TOTAL
17. Names and addresses of persons having any interest, direct or indirect, in underwritten or optioned shares or other securities or assignments, present or proposed.	The only persons holding optioned shares are certain key employees of the Company, and these stock-options are described on pages 31, 32, 55 (note 11 to Financial Statements) and 3-5 of the attached Proxy Statement. See pages 40-41 and 7 of the attached Proxy Statement for information on the stock under the Stock Purchase Plan for Fargo employees.
18. Details of any payments in cash or securities of the Company made to a promoter or finder in connection with a proposed underwriting or property acquisition.	Not applicable.
19. Details of any shares pooled, deposited in escrow, non-transferable or held under any voting trust agreement, syndicate agreement or control.	805,000 common shares, part of the stock issued in payment for properties as set out in paragraph 2 of item 9 hereof, are held in escrow by the Security Pacific National Bank, Los Angeles, California, under a contract made in April 1966. The beneficial owners are B. J. Westlund, Newton T. Bass and Virginia W. McConkey, and details are set out in note (1) on page 33 of the attached Proxy Statement.

20. Names and addresses of owners of more than a 5% interest in pooled or escrowed shares and their shareholdings. (If shares are registered in the names of nominees or in street names, give names of beneficial owners, if possible.)
- See page 33 of the attached Proxy Statement.
21. Names, addresses and shareholdings of five largest registered shareholders and if shareholdings are pooled or escrowed, so stating. If shares are registered in names of nominees or in street names, give names of beneficial owners, if possible, and if names are not those of beneficial owners, so state.

This information reflects shareholdings as, at May 1, 1968.

NAME AND ADDRESS OF SHAREHOLDER	SHARES HELD AS NOMINEE					
	FREE SHARES	ESCROWED SHARES*	TOTAL	COMMON	PREFERRED, SERIES B	
(1) B. J. Westlund 16842 Alder Circle Lake Oswego, Oregon	Common — 323,181 Pfd. "B" 16,859	535,000 —	858,181 16,859	None	None	
(2) Virginia W. McConkey Route 3, Box 372 Shelton, Washington	Common — 322,665 Pfd. "B" 11,474	135,000 —	457,665 11,474	37,236**	1,856**	
(3) Newton T. Bass P.O. Box 1 Apple Valley, California	Common — 315,768 Pfd. "B" 11,130	135,000 —	450,768 11,130	46,224**	2,304**	
(4) Dorothy R. Westlund 16842 Alder Circle Lake Oswego, Oregon	Common — 154,080 Pfd. "B" 7,680	— —	154,080 7,680	None	None	
(5) Win & Co. c/o Trust Department City National Bank & Trust Company of Kansas City P.O. Box 226 Kansas City, Mo. 64141	Common — 82,100	—	82,100	Win & Co. is a nominee for the City National Bank & Trust Company of Kansas City. The names of the beneficial owners are not known.		

*Shareholdings are escrowed as stated in items 19 and 20, above.

**Names of beneficial owners: see page 34 of the attached Proxy Statement.

22. Names and addresses of persons whose shareholdings are large enough to materially affect control of the Company.
- B. J. Westlund
16842 Alder Circle
Lake Oswego, Oregon
Virginia W. McConkey
Route 3, Box 372
Shelton, Washington
Newton T. Bass
P.O. Box 1
Apple Valley, California
23. Details of any registration with or approval or authority for sale granted by or any filing with a Securities Commission or corresponding Government body.
- Pursuant to the laws of the State of California, the place where the Company is incorporated and where it maintains its principal place of business, prior to the issuance and sale of its securities a permit to do so must be obtained from the Department of Investment, Division of Corporations, State of California.
- The Company has obtained such permits for all such issues and sales from time to time since its incorporation in 1932.
- In support of this Listing Application the Company submits the following certified copies of current permits in respect of common shares reserved for future issuance, namely:
1. Permit issued May 24, 1968, with respect to shares issuable pursuant to the terms of an Agreement and Plan of Compromise and Reorganization dated March 1, 1968 between the Company and Fargo Oils Ltd., and also with respect to shares issuable from time to time upon exercise of options to be granted under the Company's Selected Employees' Stock Option Plan — 1968.
 2. Permit issued December 19, 1967, with respect to shares issuable upon conversion of the Company's 6½% Convertible Subordinated Debentures;
 3. Permit issued March 15, 1966, with respect to shares issuable upon conversion of the Company's 5½% Cumulative Convertible (Voting) Preferred Stock, Series B (par value \$25.00);
 4. Permit issued March 22, 1965, with respect to shares issuable upon conversion of the Company's 5½% Cumulative Convertible (Voting) Preferred Stock, Series A (par value \$25.00);
 5. Permit issued July 14, 1964, as amended, January 6, 1965, January 11, 1965, January 4, 1966, January 12, 1967, January 12, 1968 and February 13, 1968, with respect to shares issuable from time to time upon exercise of options granted under the Company's Selected Employees' Stock Option Plan;
 6. Permit issued October 21, 1963, with respect to stock option granted to the President of the Company, Mr. John R. McMillan.

24. Has any application for registration with or approval or authority for sale by or any filing with a Securities Commission or corresponding Government body ever been refused, cancelled, suspended or revoked? If so, give particulars.	The Company has never had an application for registration with or approval or authority for sale by or any filing with a securities commission or corresponding government body refused, cancelled, suspended or revoked.															
25. Particulars of any bonds, debentures, notes, mortgages, charges, liens or hypothecations outstanding.	1. 6½% Convertible Subordinated Debentures due December 15, 1992; amount outstanding as at May 1, 1968: \$11,860,000.00. For details, see page 43 of the attached Proxy Statement. 2. Various secured and unsecured indebtedness in the amount of \$464,139 as at December 31, 1967. For details, see note (2) on page 9 of the attached Proxy Statement.															
26. If assets include investments in the shares or other securities of other companies, give an itemized statement thereof showing cost or book value and present market value.	<table><tr><th>COMPANY</th><th>SECURITY HELD</th><th>COST</th></tr><tr><td>1. Apple Valley Ranchos Water Co.</td><td>100% of the issued and outstanding capital stock</td><td>\$375,000.00</td></tr><tr><td>2. Reserve Chemical Co.</td><td>100% of the issued and outstanding capital stock</td><td>\$ 4,547.65</td></tr><tr><td>3. Fargo Oils Ltd.</td><td>100% of the issued and outstanding capital stock; 27.1% of which was acquired at a cost of and the remainder of which was acquired by a share exchange at the rate of 1 share of common stock of Fargo Oils Ltd. for 43% of 1 share of the Company, said shares of Fargo Oils Ltd. having a book value of (Can.\$) (being Can.\$1.48 per share, book value)</td><td>\$11,091,005.00 \$ 3,949,020.36</td></tr><tr><td>4. Frontier Hotels, Inc.</td><td>100% of the issued and outstanding capital stock</td><td>\$59,500.00</td></tr></table>	COMPANY	SECURITY HELD	COST	1. Apple Valley Ranchos Water Co.	100% of the issued and outstanding capital stock	\$375,000.00	2. Reserve Chemical Co.	100% of the issued and outstanding capital stock	\$ 4,547.65	3. Fargo Oils Ltd.	100% of the issued and outstanding capital stock; 27.1% of which was acquired at a cost of and the remainder of which was acquired by a share exchange at the rate of 1 share of common stock of Fargo Oils Ltd. for 43% of 1 share of the Company, said shares of Fargo Oils Ltd. having a book value of (Can.\$) (being Can.\$1.48 per share, book value)	\$11,091,005.00 \$ 3,949,020.36	4. Frontier Hotels, Inc.	100% of the issued and outstanding capital stock	\$59,500.00
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4. Frontier Hotels, Inc.	100% of the issued and outstanding capital stock	\$59,500.00														
27. Enumerate fully each of the following property classifications, giving claim or property numbers, approximate acreage, townships and mining camp or oil field: (a) Properties owned where titles vested in Company. (b) Properties leased. (c) Properties otherwise held. Give particulars of title held by the Company in each instance, (e.g. patented, unpatented, Crown granted, held under mining license, perpetual lease, etc.)	See pages 18-28 of the attached Proxy Statement.															
28. Full particulars of any royalties or other charges payable upon production from each individual property.	See pages 20, 22 of the attached Proxy Statement.															
29. Names and addresses of vendors of any property or other assets intended to be purchased by the Company showing the consideration to be paid.	The Company presently intends to enter into three separate transactions within the near future, which, in the aggregate, will involve the issuance of 16,816 shares of Common Stock reacquired by the Company and presently held as treasury shares and 9,600 shares of a new series of its Preferred Stock to be designated "5½% Cumulative Convertible (Non-Voting) Preferred Stock, Series C," in exchange for various minor oil and gas properties and interests in Alberta, Texas and Alaska.															
30. Names and addresses of persons who have received or will receive a greater than 5% interest in the shares or other consideration to be received by the vendor. If the vendor is a limited company, the names and addresses of persons having a greater than 5% interest in the vendor company.	There are no shareholders of the capital stock of Fargo Oils Ltd. (the vendor) or other persons connected with the vendor who have received a greater than 5% interest in the shares of the Company received by the shareholders of the vendor under the Agreement and Plan of Compromise mentioned in preceding item 29. There were no shareholders of the capital stock of the vendor who had a greater than 5% interest in the vendor.															

31. Are any lawsuits pending or in process against the Company or any of its properties, or are there any other circumstances which might affect the Company's position or title adversely? If so explain fully.	The Company knows of no pending litigation of a material nature in which the Company, or any of its subsidiaries, is currently involved.																																																																																				
32. Describe plant and equipment on property or properties.	See pages 27-29 of the attached Proxy Statement.																																																																																				
33. Describe all development accomplished and planned.	See pages 18-29 of the attached Proxy Statement.																																																																																				
34. Date and author of mining or petroleum engineer's or geologist's report filed with this application and available for inspection on request.	February 21, 1968. James A. Lewis Engineering Inc. by George S. Monkhouse, P.E., President. The report is set out on pages 24 to 25 of the attached Proxy Statement.																																																																																				
35. Full particulars of production to date.	See pages 19-25 of the attached Proxy Statement.																																																																																				
36. Have any dividends been paid? If so, give date, per share rate, and amount paid in dollars on each distribution.	The Company has not paid or declared any cash dividends on its common shares. RESERVE OIL AND GAS COMPANY PREFERRED SERIES "A" DIVIDENDS <table><tr><th>DIV. NO.</th><th>DATE PAID</th><th>PER SHARE RATE</th><th>TOTAL AMOUNT PAID</th></tr><tr><td>1</td><td>6-30-65</td><td>\$0.1394 (Partial)</td><td>\$ 4,460.80</td></tr><tr><td>2</td><td>9-30-65</td><td>0.34375</td><td>11,000.35</td></tr><tr><td>3</td><td>12-31-65</td><td>"</td><td>11,000.28</td></tr><tr><td>4</td><td>3-31-66</td><td>"</td><td>11,000.28</td></tr><tr><td>5</td><td>6-30-66</td><td>"</td><td>11,000.27</td></tr><tr><td>6</td><td>9-30-66</td><td>"</td><td>11,000.27</td></tr><tr><td>7</td><td>12-31-66</td><td>"</td><td>11,000.29</td></tr><tr><td>8</td><td>3-31-67</td><td>"</td><td>11,000.29</td></tr><tr><td>9</td><td>6-30-67</td><td>"</td><td>11,000.31</td></tr><tr><td>10</td><td>9-30-67</td><td>"</td><td>10,096.58</td></tr><tr><td>11</td><td>12-31-67</td><td>"</td><td>9,853.55</td></tr><tr><td>12</td><td>3-31-68</td><td>"</td><td>9,323.47</td></tr></table> PREFERRED SERIES "B" DIVIDENDS <table><tr><td>1</td><td>6-30-66</td><td>\$0.23798 (Partial)</td><td>\$30,550.42</td></tr><tr><td>2</td><td>9-30-66</td><td>0.34375 (Partial)</td><td>36,759.90</td></tr><tr><td>3</td><td>12-31-66</td><td>0.34375</td><td>36,759.56</td></tr><tr><td>4</td><td>3-31-67</td><td>"</td><td>36,456.73</td></tr><tr><td>5</td><td>6-30-67</td><td>"</td><td>36,456.73</td></tr><tr><td>6</td><td>9-30-67</td><td>"</td><td>36,451.91</td></tr><tr><td>7</td><td>12-31-67</td><td>"</td><td>36,368.02</td></tr><tr><td>8</td><td>3-31-68</td><td>"</td><td>36,052.47</td></tr></table>	DIV. NO.	DATE PAID	PER SHARE RATE	TOTAL AMOUNT PAID	1	6-30-65	\$0.1394 (Partial)	\$ 4,460.80	2	9-30-65	0.34375	11,000.35	3	12-31-65	"	11,000.28	4	3-31-66	"	11,000.28	5	6-30-66	"	11,000.27	6	9-30-66	"	11,000.27	7	12-31-66	"	11,000.29	8	3-31-67	"	11,000.29	9	6-30-67	"	11,000.31	10	9-30-67	"	10,096.58	11	12-31-67	"	9,853.55	12	3-31-68	"	9,323.47	1	6-30-66	\$0.23798 (Partial)	\$30,550.42	2	9-30-66	0.34375 (Partial)	36,759.90	3	12-31-66	0.34375	36,759.56	4	3-31-67	"	36,456.73	5	6-30-67	"	36,456.73	6	9-30-67	"	36,451.91	7	12-31-67	"	36,368.02	8	3-31-68	"	36,052.47
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37. Name and address of the solicitor or attorney whose certificate that the applicant is a valid and subsisting company and that the shares which have been allotted and issued were legally created and are fully paid and non-assessable has been filed with the Exchange.	Morrison, Foerster, Holloway, Clinton & Clark 11th Floor, 120 Montgomery Street San Francisco, California 94104 U.S.A.																																																																																				
38. (a) Have any shares of the Company ever been listed on any other stock exchange? If so, give particulars. (b) Is any application for listing the shares of the Company on any other stock exchange now pending or contemplated? If so, give particulars.	(a) American and Pacific Coast Stock Exchanges. (b) Yes. Application to list 2,773,080 Common shares (in addition to 6,021,446 presently listed common shares) on the American and Pacific Coast Stock Exchanges, which is being made concurrently herewith.																																																																																				

(c) Has any application for listing of any shares of the Company ever been refused or deferred by any stock exchange? If so, give particulars.	(c) No.
39. Particulars of the principal business in which each officer and director has been engaged during the past five years, giving the length of time, position held and name of employing company or firm.	See page 30 of the attached Proxy Statement.
40. The dates of and parties to and the general nature of every material contract entered into by the Company which is still in effect and is not disclosed in the foregoing. Except for management contracts, do not include particulars of any contract entered into in the ordinary course of business carried on or intended to be carried on by the Company.	See pages 18-28, and 30-31, of the attached Proxy Statement.
41. Any other material facts not disclosed in the foregoing.	To the knowledge of the signatories hereto, there are no other material facts, apart from those disclosed herein and in the Proxy Statement which is attached hereto.

42. STATEMENT SHOWING DISTRIBUTION OF ISSUED CAPITAL

as of May 1, 1968

FREE STOCK

	SHARES	SHARES
(a) Distributed and in the hands of the public (exclusive of the promoters, officers and directors of the Company and their agents or trustees).	Common 2,446,146.5* Pfd. A 26,987 Pfd. B 76,533 *	2,549,666.5
(b) Distributed and in the hands of the promoters, officers and directors of the Company and their agents or trustees.	Common 1,458,274.5 Pfd. A 110 Pfd. B 30,647	1,489,031.5
Total free stock		4,038,698.0

ESCROWED OR POOLED STOCK

(c) Held in escrow or pool as set out in Item 19 of this application.	Common	805,000
Total issued capital		4,843,698

RECORD OF SHAREHOLDERS

Number of registered shareholders holding shares in class (a) above	6,611
Number of registered shareholders holding shares in class (b) above	11
Number of registered shareholders holding shares in class (c) above	3

* Includes 20,387 Common and 2,435 Preferred Series B held in the Treasury.

Pfd. Series A

NUMBER	SHARES
385 Holders of 1 — 99 shares	5,746
27 " " 100 — 499 "	5,538
6 " " 500 — 999 "	4,215
2 " " 1000 — 1999 "	2,207
4 " " 2000 — 2999 "	9,391
" " 3000 — 3999 "	
" " 4000 — 4999 "	
" " 5000 — up "	
424 Stockholders	Total Shares 27,097

Pfd. Series B

NUMBER	SHARES
595 Holders of 1 — 99 shares	7,597
63 " " 100 — 499 "	14,834
12 " " 500 — 999 "	10,157
10 " " 1000 — 1999 "	13,248
3 " " 2000 — 2999 "	7,082
" " 3000 — 3999 "	
" " 4000 — 4999 "	
5 " " 5000 — up "	54,262
688 Stockholders	Total Shares 107,180

43. STATEMENT SHOWING NUMBER OF SHAREHOLDERS

as of May 1, 1968

Common

NUMBER	SHARES
2,166 Holders of 1 — 99 shares	93,839
2,649 " " 100 — 499 "	490,034
293 " " 500 — 999 "	212,570
200 " " 1000 — 1999 "	254,234
60 " " 2000 — 2999 "	138,265
32 " " 3000 — 3999 "	106,723
21 " " 4000 — 4999 "	92,785
89 " " 5000 — up "	3,320,971
5,510 Stockholders	Total 4,709,421
	*2,670,044
	TOTAL SHARES 7,379,465

* Note—Between May 1, 1968, and June 10, 1968, 2,670,044 common shares were issued, as follows:

2,668,257 to former shareholders of Fargo Oils Ltd., in accordance with the Agreement and Plan of Compromise and Reorganization described on pages 1, 5-8 and (1) to (7) of the attached Proxy Statement.

1,600 in connection with the exercise of stock options under the Selected Employees' Stock Option Plan—1964.

160 for conversion of preferred shares, Series B.

27 for conversion of preferred shares, Series A.

RESERVE OIL AND GAS COMPANY

550 SOUTH FLOWER STREET
LOS ANGELES, CALIFORNIA 90017

March 8, 1968

TO OUR SHAREHOLDERS:

You will find enclosed a notice of annual meeting of the shareholders of your Company ("Reserve"), a proxy statement and a form of proxy. At this meeting, shareholders will be asked (1) to elect the Board of Directors for the ensuing year, (2) to approve the Company's "Selected Employees' Stock Option Plan—1968", and (3) to approve and adopt an Agreement and Plan of Compromise and Reorganization dated as of March 1, 1968 (the "Plan") between Reserve and Fargo Oils Ltd., an Alberta, Canada, corporation ("Fargo"), a copy of which is annexed to the proxy statement.

ELECTION OF DIRECTORS

The shareholders will be asked to re-elect nine of the present ten directors of the Company, which will leave one vacancy in the Board. Management does not intend to fill this vacancy until some future date. Information concerning the nine nominees is set forth in the Proxy Statement under Proposal 1.

STOCK OPTION PLAN

Management will present to the meeting for approval a Selected Employees' Stock Option Plan—1968 adopted by the Board of Directors at a meeting on March 5, 1968. From the experience of the Company under the Stock Option Plan approved in 1964, Management is convinced that stock ownership by key employees is a strong stimulant to effective performance and is important to the interests of the Company and its shareholders. The Stock Option Plan is described in detail in the Proxy Statement under Proposal 2.

THE PLAN

The third and very important issue to be voted on by the shareholders is the approval and adoption of the Agreement and Plan of Compromise and Reorganization dated as of March 1, 1968, between Reserve and Fargo Oils Ltd., hereinafter referred to and more particularly described in the Proxy Statement under Proposal 3.

Briefly stated, the Plan provides that Reserve will issue shares of its Common Stock (\$1 par value) to Guaranty Trust Company of Canada, Calgary, Alberta, Canada, as trustee for Fargo shareholders (other than Reserve and Fargo shareholders who effectively dissent from the Arrangement, a copy of which is annexed as Schedule "A" to the Plan), in order that Fargo shall become a wholly-owned subsidiary of Reserve. The Plan provides that upon ratification by a majority in number representing three-fourths of the shares of Fargo voting either in person or by proxy at a meeting of the shareholders of Fargo called for that purpose, and upon agreement to the Arrangement by the same majority of the shareholders of Fargo, the Arrangement shall be presented to the Supreme Court of the Province of Alberta for sanction as required by the provisions of Sections 139 and 140 of The Companies Act of Alberta (subject to satisfaction of other conditions).

Upon sanction of the Arrangement by the Court, the Company will issue to Guaranty Trust Company of Canada, as trustee, such number of full paid and nonassessable shares of Common Stock of Reserve as may be required to enable the shareholders of Fargo (except Reserve and the effectively dissenting shareholders) to become holders of Common shares of Reserve on the Closing Date. If the Plan shall not be terminated as provided therein, the Closing Date shall be the date upon which the Company and Fargo shall give notice, one to the other, that certain conditions of the Plan have been met, including sanction of the Arrangement by the Court. Pursuant to the Plan and the Arrangement on the Closing Date all holders of certificates representing shares of Fargo (other than Reserve) shall cease to

be shareholders of that company, Reserve shall become and be the sole shareholder of Fargo, and thereafter each certificate formerly representing shares of Fargo (other than certificates held by Reserve) shall thenceforth represent (a) in the case of a Fargo shareholder, who is not a dissident, the right upon surrender of his certificate to Guaranty Trust Company of Canada on or before a specified date to receive the number of whole shares of Reserve Common Stock to which such holder is entitled under the terms of the Arrangement and payment for any fractional share of Reserve to which such holder would be entitled, or (b) in the case of a shareholder of Fargo, who is a dissident, the right upon surrender of his certificate to Guaranty Trust Company of Canada to receive from Fargo such award as may be made by or as a result of any direction of the Court.

Upon consummation of the Plan and Arrangement, each shareholder of Fargo (other than Reserve) who is not a dissident shall be entitled to 43/100ths share of Common Stock of Reserve for each one share of Common Stock of Fargo (i.e., 43 shares of Reserve Common for each 100 shares of Fargo Common). This ratio of exchange was recommended by Lehman Brothers, One William Street, New York, New York, internationally known investment bankers, acting for Reserve, and Richardson Securities of Canada, Winnipeg, Manitoba, Canada, investment bankers, acting for Fargo, upon consideration of various factors as set forth in the proxy statement, and their recommendations have been accepted by the directors of Reserve and Fargo.

Fargo is an amalgamated company under the laws of the Province of Alberta, under and by virtue of a certificate of amalgamation dated June 30, 1960, issued by the Registrar of Companies of the Province of Alberta. Fargo has been engaged in the business of exploring for, developing and producing oil and gas in the Western Provinces of Canada. On September 7, 1967, Reserve purchased 2,310,626 shares of the Common Stock of Fargo (27.1% of its outstanding stock) for \$11,091,004.80 cash (i.e., \$4.80 per share) from General American Oil Company of Texas. Upon consummation of the purchase, four of the seven members of the Board of Directors of Fargo resigned and Messrs. Newton T. Bass, John R. McMillan, Marco F. Hellman and Howard C. Pyle, all directors of Reserve, were elected to fill the vacancies thus created; and at the same time, John R. McMillan, President of Reserve, was elected President of Fargo, and Paul D. Meadows, Vice President of Reserve, was elected Executive Vice President of Fargo (see "Description of Business and Properties of Fargo" in the accompanying proxy statement).

The acquisition by Reserve of the remaining outstanding stock of Fargo will result in Fargo becoming a wholly-owned subsidiary of Reserve and will permit the consolidation of the operations of the two companies in Canada (where Reserve is already actively operating—see "Description of Business and Properties of Reserve" in the accompanying proxy statement) and will permit the consolidation of the accounts of Reserve and Fargo for shareholder accounting purposes.

The accompanying proxy statement sets forth in detail the business and properties and financial condition of Reserve and Fargo separately and on a pro forma combined basis.

Your Board of Directors has approved and adopted the Plan and recommends like action by the shareholders.

Regardless of the number of shares you hold, your shares should be voted on this important issue. We hope you will attend the meeting if you can conveniently do so. If you cannot attend, or if you expect to be present but wish to have your stock voted by proxy, we ask that you sign, date and return the enclosed proxy as soon as possible.

Sincerely,

JOHN R. McMILLAN, *President*

A RETURN ENVELOPE, WHICH REQUIRES NO POSTAGE IF MAILED IN THE UNITED STATES, IS ENCLOSED FOR YOUR CONVENIENCE.

Your Board of Directors has fixed the close of business on March 8, 1968, as the record date for determination of the shareholders of Reserve entitled to notice of, and to vote at, the meeting and any adjournment or adjournments thereof.

RESERVE OIL AND GAS COMPANY

NOTICE OF ADJOURNED ANNUAL MEETING OF SHAREHOLDERS TO BE HELD APRIL 25, 1968

The adjourned annual meeting of shareholders of Reserve Oil and Gas Company will be held in the Los Angeles Room of the Statler Hilton Hotel, 930 Wilshire Boulevard, Los Angeles, California, on Thursday, April 25, 1968, at 10:00 A.M., for the following purposes:

1. **Proposal 1.** To elect a Board of Directors for the ensuing year and until their successors are elected and qualified;

2. **Proposal 2.** To consider and vote upon a proposal to approve the Company's "Selected Employees' Stock Option Plan—1968", a copy of which is attached as Exhibit 2.

3. **Proposal 3.** To consider and vote upon a proposal to approve and adopt an Agreement and Plan of Compromise and Reorganization dated as of March 1, 1968 (the "Plan"), providing for the transfer to this Company of all the outstanding stock of Fargo Oils Ltd., an Alberta corporation ("Fargo"), except shares presently owned by this Company, to the end that Fargo will become a wholly-owned subsidiary of this Company, in exchange for shares of the Company's Common Stock.

(The terms and provisions of the Plan are summarized in the accompanying proxy statement, and a copy thereof is attached as Exhibit 1.)

4. To consider and act upon such other business as may properly come before the meeting and any adjournment or adjournments thereof.

Only holders of stock of the Company of record at the close of business on March 8, 1968, will be entitled to notice of, and to vote at, this meeting, or any adjournment or adjournments thereof.

The holders of all classes of stock of the Company (Series A Preferred, Series B Preferred and Common, voting together as a group) may vote for the election of the Board of Directors and upon the approval of Proposals 2 and 3. A favorable vote of not less than a majority of all classes of stock (voting as a group) is required for the approval of Proposals 2 and 3.

Shareholders who do not expect to attend the meeting in person are requested to complete, sign and date the enclosed proxy and return it promptly in the enclosed addressed and stamped envelope.

BY ORDER OF THE BOARD OF DIRECTORS.

HAROLD F. GREEN, *Secretary*

Los Angeles, California
March 8, 1968.

RESERVE OIL AND GAS COMPANY

550 SOUTH FLOWER STREET
LOS ANGELES, CALIFORNIA 90017

PROXY STATEMENT

**For Adjourned Annual Meeting of Shareholders
To Be Held April 25, 1968**

TABLE OF CONTENTS

	<u>Page</u>		<u>Page</u>
Solicitation and Voting Rights.....	1	Commercial and Residential Properties and Other Activities	25
Election of Directors.....	2	Other Commercial Properties.....	28
Stock Option Plan.....	3	Fertilizer Production	28
Description of Plan.....	5	Competition	29
General	5	Employees	29
Determination of Exchange Ratios and Expenses...	6	Management of the Company.....	29
Description of Arrangement.....	6	Directors and Officers.....	29
Provision for Fargo Options.....	7	Remuneration of Directors and Officers.....	30
Rights of Dissenting Shareholders.....	7	Thrift Plan	31
Reserve Shareholders	7	Stock Options	31
Fargo Shareholders	7	Interest of Management and Others in Certain Transactions	32
Termination of Plan.....	7	Principal Holders of Equity Securities.....	33
Tax Status	8	Description of Business and Properties of Fargo....	34
Description of Reserve Oil and Gas Company and of Fargo Oils Ltd.....	8	General	34
Capitalization	9	Oil and Gas.....	34
Capitalization Table—The Company—Fargo—Pro Forma Combined	9	Oil and Gas Sales.....	35
Comparative Data	10	Drilling Operations	35
Range of Security Prices.....	10	Oil and Gas Properties.....	35
Earnings Per Share.....	10	Oil and Gas Reserves.....	36
The Company	10	Gas Plants	38
Fargo	11	Sulphur Plant	38
Pro Forma Combined.....	11	Pipeline Company	39
Comparison of Book Values Per Share.....	12	Competition and Regulation.....	39
Comparison of Hydrocarbon Reserves.....	12	Employees	39
Statement of Income—Reserve.....	13	Management of Fargo.....	40
Statement of Income—Fargo.....	15	Directors and Officers.....	40
Pro Forma Combined Statement of Income.....	16	Remuneration of Directors and Officers.....	40
Pro Forma Combined Condensed Balance Sheet.....	17	Stock Purchase Plan.....	40
Dividend Policies	18	Principal Shareholders	41
Description of Business and Properties of the Company	18	Description of Securities of Reserve.....	42
General	18	Description of Debentures.....	42
Oil and Gas.....	19	Description of Capital Stock of Reserve.....	43
Western United States Operations.....	19	Dividend Rights	43
Mid-Continent Operations	20	Voting Rights	43
Exploration Program	21	Liquidation Rights	44
Canadian Operations	21	Conversion Rights	44
Oil and Gas Sales.....	22	Redemption Rights	44
Drilling Operations	22	Preemptive and Other Rights.....	44
Oil and Gas Properties.....	23	Index to Financial Statements.....	45
Oil and Gas Reserves.....	23	Agreement and Plan of Compromise and Reorganiza- tion—Exhibit 1	(1)
Regulation	25	Arrangement—Schedule "A"	(5)
		Selected Employees' Stock Option Plan—1968— Exhibit 2	-1-

RESERVE OIL AND GAS COMPANY

PROXY STATEMENT

SOLICITATION AND VOTING RIGHTS

The proxy that accompanies this proxy statement is being solicited by and on behalf of the management of Reserve Oil and Gas Company, a California corporation ("Reserve"), for use at the adjourned annual meeting of shareholders to be held on April 25, 1968, at the place and for the purposes set forth in the accompanying notice of adjourned annual meeting of shareholders, and at any adjournment or adjournments thereof. In addition to solicitation of proxies by mail, certain officers, directors and employees of Reserve, none of whom will receive additional compensation therefor, may solicit proxies by telephone, telegram, or by personal contact. All expenses in connection with solicitation, including postage, printing and handling, and the actual expenses incurred by brokerage houses, custodians, and nominees and fiduciaries in forwarding proxy material to beneficial owners, will be paid by Reserve.

As of March 8, 1968, there were 4,705,535 shares of Reserve Common Stock, 27,122 shares of Reserve Series A Preferred Stock, and 107,338 shares of Reserve Series B Preferred Stock, issued and outstanding, including treasury shares.

The holders of all classes of stock of the Company (Series A Preferred, Series B Preferred and Common, voting together as a group) may vote for the election of the Board of Directors (Proposal No. 1), and each share is entitled to one vote. Each shareholder will be entitled to vote his shares cumulatively, which means that he will be entitled to as many votes as he has shares of stock multiplied by the number of directors to be elected, and he may cast all such votes for a single director, or may distribute them among the number to be voted for, or any two or more of them, as he sees fit.

The holders of all classes of stock of the Company (Series A Preferred, Series B Preferred and Common, voting together as a group) may vote upon the approval of the Selected Employees' Stock Option Plan—1968 (Proposal No. 2), and each share is entitled to one vote. A favorable vote of not less than a majority of all classes (voting as a group) is required for the approval of the Selected Employees' Stock Option Plan—1968.

The holders of all classes of stock of the Company (Series A Preferred, Series B Preferred and Common, voting together as a group) may vote upon the approval of the Agreement and Plan (Proposal No. 3), and each share is entitled to one vote. A favorable vote of not less than a majority of all classes (voting as a group) is required for the approval of the Agreement and Plan.

Shares may be voted either in person or by proxy. Only shareholders of record at the close of business on March 8, 1968, will be entitled to vote. The person giving the enclosed proxy may revoke it at any time prior to its effective use.

The accompanying proxy will be voted at the meeting, or any adjournment or adjournments thereof, as directed in respect of (a) election of the Board of Directors, (b) the approval of the Selected Employees' Stock Option Plan—1968, and (c) the approval and adoption of the Agreement and Plan of Compromise and Reorganization dated as of March 1, 1968 (the "Plan"), between Reserve and Fargo Oils Ltd. ("Fargo"), set forth in Exhibit 1. If no direction is indicated, the proxy will be voted for (1) election of the nominees of the management for directors, (2) approval of the Selected Employees' Stock Option Plan—1968, and (3) approval and adoption of the Agreement and Plan.

The management is not aware at this time of any other matters that may be presented to the meeting, but in the event that any other matters should come before the meeting for action, including, but not limited to, a motion to adjourn, the enclosed proxy will be voted in such manner as a majority of the named proxies shall determine in their discretion.

In the event that one or more persons, other than the management nominees, are nominated as candidates for directors, the enclosed proxy may be voted in favor of any one or more of the management nominees to the exclusion of the others and in such order of preference as a majority of the designated proxies may determine in their discretion. In the event one or more of the management nominees is or will be unable or unwilling to serve for reasons unknown at the date of this proxy statement, one or more other persons may be nominated and the enclosed proxy voted in favor of any one or more of the management nominees to the exclusion of the others and in favor of such substitute nominee or nominees in such order of preferment as a majority of the named proxies may determine in their discretion. In any event, the shares represented by the proxy will be voted for the election of directors unless direction is given to the contrary in the proxy.

PROPOSAL 1

ELECTION OF DIRECTORS

Nine (9) directors are to be elected at the meeting, each to hold office for a term of one (1) year and thereafter until their successors are elected and qualified. There is one vacancy in the Board which management intends to fill at some future date, but for which no nominee has been selected. The proxies solicited hereby will not be voted to fill such vacancy. The following-named nominees of the management are presently directors of the Company, and, except as hereinafter stated, the enclosed proxy will be voted in favor of their election as directors.

Name of Nominee	Principal Occupation and Position with the Company	Year First Elected Director	Equity Securities Owned Beneficially as of January 31, 1968†	
			Common	Preferred Series B
Newton T. Bass	Chairman of the Board.	April 1966	450,768①	11,130①
Clinton La Tourrette②	Partner of LaTourrette & Co., Financial Consultants, Director.	1958	5,956.5③	None
Howard C. Pyle	Petroleum Investments, Director.	1962	2,000	None
John R. McMillan	Director, President, and Chief Executive Officer.	1963	4,100	None
Marco F. Hellman	Senior Partner of J. Barth & Co., Investment Bankers, San Francisco, Director.	1964	20,600④	None
Joseph A. Ball	Partner, Ball, Hunt, Hart and Brown, Attorneys, Director.	April 1966	46,660⑤	None⑥
Llewellyn Bixby, Jr.	President of Bixby Land Company, Director.	April 1966	10,384	1,242
Walter E. Cramer, Jr.	Vice President and Director.	April 1966	23,136⑥	1,306⑥
B. J. Westlund	Retired Businessman, Director.	April 1966	858,181⑦	16,859⑦

† None of the Directors hold shares of the Company's Series A Preferred Stock, or 6½% Convertible Subordinated Debentures due December 15, 1992.

① Does not include the following shares, beneficial ownership of which is disclaimed by Mr. Bass:

- 1,718 shares of Common Stock and 81 shares of Series B Preferred which are held by Frances A. Bass, wife of Mr. Bass;
- 1,028 shares of Common Stock and 52 shares of Series B Preferred which are held by Frances A. Bass as Custodian for the two minor children of Mr. and Mrs. Bass;
- 37,236 shares of Common Stock and 1,856 shares of Series B Preferred which are held by Mr. Bass and Virginia W. McConkey, Trustees of the Leann Bass Brauch Trust No. 1; or
- 8,988 shares of Common Stock and 448 shares of Series B Preferred which are held by Mr. Bass and Norman Rasmussen, Trustees of the Eric Bass Family Trust.

- ③ Of the shares owned beneficially by Mr. LaTourrette 3,589 shares are owned by LaTourrette & Co., a partnership in which Mr. LaTourrette is a partner owning a 50% interest and 8,188 shares are owned by Pacific Capital Corporation, all of the capital stock of which is owned by LaTourrette & Co.
- ③ Does not include 9,012.5 shares owned by Elizabeth LaTourrette, wife of Mr. LaTourrette, or 1,435 shares owned by Mr. and Mrs. LaTourrette as Trustees for their son, Peter LaTourrette. Mr. LaTourrette disclaims that he is the beneficial owner of these shares.
- ④ Does not include 23,000 shares owned by Ruth K. Hellman, wife of Mr. Hellman. Mr. Hellman disclaims that he is the beneficial owner of these shares.
- ⑤ Does not include 814 shares of Common Stock and 26 shares of Series B Preferred which will be owned by Elinor Ball, wife of Mr. Ball. Mr. Ball disclaims that he is the beneficial owner of these shares.
- ⑥ Includes 257 shares of Common Stock and 13 shares of Series B Preferred owned by Mr. Cramer and his father, Walter E. Cramer, Sr., as joint tenants. Does not include 257 shares of Common Stock and 13 shares of Series B Preferred owned by Wesley N. Cramer, son of Mr. Cramer, and a like amount by Linda J. Cramer, daughter of Mr. Cramer. Mr. Cramer disclaims that he is the beneficial owner of these shares.
- ⑦ Does not include 154,080 shares of Common Stock and 7,680 shares of Series B Preferred Stock owned by Dorothy R. Westlund, wife of Mr. Westlund. Mr. Westlund disclaims that he is the beneficial owner of these shares.

Each of the directors has served continuously since the date first elected a director. For more than five years prior to their election as directors of the Company, Mr. Newton T. Bass had been President, director and Chief Executive Officer of Apple Valley Building and Development Company (acquired by the Company in 1966); Mr. B. J. Westlund had been a director and major shareholder of Apple Valley; and Mr. Walter E. Cramer, Jr., had been an officer and director of Apple Valley, devoting his full time to its management; Mr. Joseph A. Ball had been a director of Apple Valley and was and is a partner of Messrs. Ball, Hunt, Hart & Brown, attorneys at law, Long Beach, California. Mr. Llewellyn Bixby, Jr., in addition to being President of Bixby Land Company for more than five years prior to his first election as a director of the Company, had been President and a director of Long Beach Dock and Terminal Company (acquired by the Company in 1966). Mr. Howard C. Pyle at the present time is engaged in petroleum investments. From 1961 to 1967 he was a partner in Lacle Petroleum Company. Messrs. Marco F. Hellman and Clinton LaTourrette have been principally employed in the occupations shown above during the past five years. Mr. John R. McMillan, President, director and Chief Executive Officer of the Company since 1963, was an officer of Humble Oil & Refining Company and of Monterey Gas Transmission Company from 1961 through 1963.

Further information concerning the shareholdings of certain of the directors of the Company is set forth herein under the caption "Management of the Company"—"Principal Holders of Equity Securities". See also caption "Management of the Company"—"Interest of Management and Others in Certain Transactions."

Remuneration of directors and officers is set forth herein under the caption "Management of the Company"—"Remuneration of Directors and Officers." See also herein caption "Management of the Company"—"Principal Holders of Equity Securities."

PROPOSAL 2

APPROVAL OF SELECTED EMPLOYEES' STOCK OPTION PLAN—1968

The management will present to the meeting for approval a Selected Employees' Stock Option Plan—1968 (the "Option Plan"), adopted by the Board of Directors at a meeting held on March 5, 1968. This Option Plan provides for the granting to key employees of options to purchase Common Stock of the Company.

By its action at the meeting on March 5, 1968, the Board of Directors established a Selected Employees' Stock Option Plan—1968 subject to approval by the holders of a majority of the outstanding shares of stock of the Company, a copy of which is attached to this Proxy Statement as Exhibit 2. The purpose of the Option Plan is to provide a means whereby key employees of the Company and its affiliates (including Officers and Directors who are employees) may be given an opportunity to purchase shares

of the Common Stock of the Company under options which will qualify as "qualified stock options" under Section 422 of the Internal Revenue Code as it is now in effect or as it may hereafter be amended from time to time.

Such options may be granted under the Option Plan from time to time enabling key employees of the Company to whom options are granted to purchase an aggregate of not more than 100,000 shares of the Company's Common Stock (\$1 par value). If an option is surrendered or for any other reason ceases to be exercisable in whole or in part, the shares which were subject to such option, but as to which the option had not been exercised, shall continue to be available under the Option Plan.

The maximum number of shares for which an option or options may be granted under the Option Plan to any employee during any period of five years shall be 15,000.

The Option Plan provides that it shall be administered by a committee of not less than three Directors of the Company, to be appointed by the Board of Directors. No member of the committee is eligible to receive an option. A majority of the committee shall constitute a quorum. The committee may from time to time determine which employees of the Company or of its affiliates shall be granted options under the Option Plan and the number of shares for which an option or options shall be granted to each such employee.

Each option is to be evidenced by a written Stock Option Agreement under which the option price shall be the reported highest price of the Company's shares on the American Stock Exchange on the day the option is granted, or if no sale of the Company's stock shall have been made on such Exchange on that day, on the next preceding day on which there was such a sale.

The period for exercising an option shall be the period beginning twelve months from the date on which the option is granted and ending on a date determined by the committee, but in no event on a date later than five years from the time the option is granted, except that (i) if an optionee ceases to be an employee of the Company or an affiliate for any cause other than death during the option period, the option shall be exercisable only prior to the end of the three-month period following termination of employment or prior to the end of the option period, whichever shall first occur, provided that if termination is for cause, the option shall terminate on the date of termination of employment; and (ii) if an optionee dies during the option period, the option shall only be exercisable by the estate of the optionee (or by such person who acquired the right to exercise the option by bequest or inheritance or by reason of the death of the optionee) prior to the end of the twelve-month period following death or prior to the end of the option period, whichever shall first occur.

If there shall be any change in the shares subject to the Option Plan, or in any option granted thereunder, through merger, consolidation, reorganization, recapitalization, reincorporation, stock dividend or other change in corporate structure, appropriate adjustments shall be made by the committee in the aggregate number of shares subject to the Option Plan, the maximum number of shares for which options may be granted to any one employee and the number of shares and the price per share subject to outstanding options in order to preserve, but not to increase, the benefits of the optionee; provided, however, that subject to any required action by the shareholders, if the Company shall not be the surviving corporation in any merger, consolidation or reorganization, every option outstanding thereunder shall terminate, unless the surviving corporation shall (subject to applicable provisions of the Internal Revenue Code) substitute a new option therefor or assume (with appropriate changes) the existing option. If the option shall terminate by reason of such merger, consolidation or reorganization, then, notwithstanding the option period, the option may be exercised, in whole or in part, by the optionee at any time prior to or concurrently with consummation of such merger, consolidation or reorganization. The committee may include in the Stock Option Agreement more detailed provisions with respect to such adjustments.

In consideration of the granting of the option, the optionee shall agree (i) to remain in the employ of the Company or an affiliate for a period of at least one year after the option is granted, subject to the right of the Company or such affiliate to terminate his employment at any time for any reason whatsoever; (ii) that during the lifetime of the optionee the option shall be exercisable only by the

optionee and shall not be transferable except by will or the laws of descent and distribution; and (iii) in the discretion of the committee, that such optionee, and each person who shall exercise such option, shall represent that any and all shares purchased pursuant to such option will be purchased for investment and not with a view to the distribution or resale thereof.

The Company is advised by counsel that if an optionee under the Option Plan meets the holding requirements of Section 422 of the Internal Revenue Code as to shares purchased on the exercise of an option granted under the Option Plan (i.e., three years after exercise of the option) the Company will be entitled to no federal income tax deduction in connection with the issuance or exercise of the option and the optionee will not receive income for federal income tax purposes but will, upon the sale of the shares so purchased, be taxed at the capital gains rate on any amounts realized by him in excess of the option price or will be entitled to a capital loss on any loss sustained by him as the result of such sale. If the employee sells the stock within three years after exercise of the option then the employee will realize ordinary income up to the lesser of (i) gain measured by the difference between what he paid for the stock and what he sold it for, or (ii) the spread between the option price and the value of the stock at the time he exercised the option. If his gain is more than the spread, the excess of gain over the spread will be capital gain, either short-term or long-term depending on his holding period of the stock.

No determination has been made with respect to whom the qualified stock options may be granted pursuant to the Option Plan. Persons to whom qualified stock options may be granted pursuant to the Option Plan may include officers of the Company, and in the case of one officer presently holding a restricted stock option, such qualified stock options may be granted at a lower option price. However, in such case, such qualified stock option cannot be exercised until the previously granted restricted stock option is fully exercised or lapsed or cancelled without loss of the tax benefit which would otherwise result therefrom.

The closing price of the Company's Common Stock on the American Stock Exchange on March 27, 1968, was \$12.00 per share.

With respect to stock options heretofore granted by the Company, see "Management of the Company"—"Stock Options," and Note 11 to "Notes to Financial Statements—Reserve" appearing elsewhere in this Proxy Statement.

PROPOSAL 3

DESCRIPTION OF THE PLAN

General

Under the Plan, which the shareholders of the Company are asked to approve, Fargo agreed to enter into an Arrangement with its shareholders under the provisions of which all the outstanding shares of Fargo, other than those held by Reserve, would be exchanged for Common shares of Reserve, par value \$1 per share, in the ratio of 43/100ths share of Reserve for each one share of Fargo (i.e., 43 shares of Reserve Common for each 100 shares of Fargo Common). No fraction of a share of Reserve will be issued but on the first business day following the effective date of the Arrangement, the aggregate of all fractional interests will be sold on the American Stock Exchange and the net proceeds paid as promptly as practicable to the Fargo shareholders entitled thereto. Following completion of this share exchange, Fargo will become the wholly-owned subsidiary of Reserve and shall be amalgamated with Reserve at such time as such considerations as income tax and contractual obligations make such action convenient and desirable. The full terms of the Arrangement are set forth in Schedule "A" to the Plan.

If the Plan is consummated, the present (March 8, 1968) shareholders of Reserve will hold 4,705,535 shares of Reserve Common Stock, including treasury shares (with 73,250 shares reserved for issuance upon exercise of stock options, and 1,242,661 shares reserved for issuance upon conversion of Reserve Series A Preferred Stock, Reserve Series B Preferred Stock and Reserve's \$14,000,000 of 6½% Convertible Subordinated Debentures due December 15, 1992), and the present (March 1, 1968) Fargo shareholders (other than Reserve and assuming there are no dissenting Fargo shareholders) will hold 2,669,894 shares of Reserve Common Stock.

Determination of Exchange Ratio and Expenses

Because four of the seven directors of Fargo are also directors of Reserve, the exchange ratio could not be negotiated in an arm's length transaction. Accordingly Reserve engaged Lehman Brothers, One William Street, New York, New York 10004, internationally known investment bankers, and Fargo engaged Richardson Securities of Canada, Winnipeg, Manitoba, Canada, investment bankers, to recommend the exchange ratio under the Plan and Arrangement and their recommendations have been accepted by the directors of Reserve and Fargo. Pertinent factors considered by Lehman Brothers and Richardson in arriving at the exchange ratio include past performance and growth prospects of Reserve and Fargo; assets, liabilities and earnings of Reserve and Fargo; price ranges of Common Stock of Reserve and Fargo; analyses of future recoverable hydrocarbons, and present worth thereof, of Reserve and Fargo; analyses of present worth of unexplored (wildcat) acreage owned by Reserve and Fargo; and analysis of present worth of real estate holdings of Reserve.

For the services of Lehman Brothers in this matter Reserve paid it \$20,000. For the services of Richardson Securities of Canada in this matter Fargo paid it \$10,000.

No compensation or commissions are to be paid in connection with the Plan and Arrangement. Expenses of Fargo will be paid by Fargo and expenses of Reserve will be paid by Reserve.

Description of the Arrangement

The Plan and Arrangement must be ratified and approved by a majority of the shareholders of Reserve (Series A Preferred, Series B Preferred and Common voting as a group), and by the affirmative vote of a majority in number representing three-fourths of the shares voted, either in person or by proxy, at a special meeting of shareholders of Fargo called for that purpose. A quorum at the Special Meeting of Fargo consists of not less than two shareholders present in person or represented by proxy holding not less than 10% of the issued and outstanding shares of Fargo. Reserve is the owner of 2,310,626 common shares of Fargo and intends to vote those shares in favor of ratifying the Plan and agreeing to the Arrangement. In the event that the Plan is ratified by the shareholders and the Arrangement is agreed to by the required affirmative vote, it is contemplated that application will be made by Fargo to a Judge of the Supreme Court of Alberta under the provisions of Sections 139 and 140 of The Companies Act of Alberta for an order sanctioning the Arrangement subject to such disposition with respect to dissenting shareholders as the Court may direct.

Under the terms of the Arrangement, it is contemplated that it will be effective on the thirtieth day after the date of the Order of the Court sanctioning the Arrangement, unless the Arrangement is terminated as hereinafter set forth. Following sanction by the Court of the Arrangement, Reserve has undertaken to issue to Guaranty Trust Company of Canada, as trustee for the former Fargo shareholders, sufficient shares to enable Fargo to carry out the terms of the Arrangement, provided the following conditions have been met and satisfied:

1. A ruling or opinion of counsel that the shares distributed as a result of the Arrangement are not subject to the Interest Equalization Tax imposed under the Interest Equalization Tax Act of the United States of America.
2. An authorization, exemption or specific license be obtained by Reserve from the Director, Office of Foreign Direct Investments, Department of Commerce, United States of America, if such shall be required by Executive Order No. 11387 and Regulations issued thereunder.
3. Listing (on notice of issuance) on the American and Pacific Coast Stock Exchanges of the shares of Reserve required for completion of the Arrangement.
4. An opinion of counsel that the issuance of the shares of Reserve required for completion of the Arrangement is exempt from registration under the Securities Act of 1933, as amended, of the United States of America, or that a registration statement under said Securities Act shall have become effective with respect to said shares and that the issuance of such shares is exempt from registration under the

security laws of the Provinces of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario and Quebec.

5. Certain other conditions more particularly set out in the Plan.

Provision for Fargo Options

Reserve has undertaken to make available a sufficient number of shares of its Common Stock to satisfy the requirements of any options of Fargo to be allotted under Fargo's stock purchase plan to employees covering their earnings for the year 1968. This would require the issue of a maximum of 3,186 Reserve Common shares.

Rights of Dissenting Shareholders

RESERVE SHAREHOLDERS.

Upon approval of the Plan by a majority of the shareholders of Reserve, no shareholder of Reserve has any appraisal rights or other rights of dissent with respect to the Plan.

FARGO SHAREHOLDERS.

If the Arrangement is agreed to by the requisite majority of the shareholders of Fargo, as provided for by Section 139 of The Companies Act and as outlined above, then, as soon as possible after the expiration of seven days from the date upon which the shareholders of Fargo agree to the Arrangement, Fargo will apply to the Court for an Order sanctioning the Arrangement; and if any shareholder of Fargo who did not vote in favor of the Arrangement shall, within the said period of seven days, have expressed his desire to dissent therefrom by a notice in writing addressed to Fargo and sent to or left at its registered office, such notice shall be brought to the attention of the Court on the said application and Fargo shall give notice to such shareholder of any direction made by the Court.

The failure of a Fargo shareholder to vote against ratification of the Plan does not constitute a waiver of his right as a dissident. However, whether the Fargo shareholder votes against ratification of the Plan or does not vote at all, such shareholder must, within seven days after the Fargo shareholders' meeting, send to or leave with Fargo, at its head office, a written notice of his desire to dissent from the Plan.

Upon consummation of the Plan and Arrangement (a) all holders of certificates representing shares of Fargo shall cease to be shareholders of Fargo (other than Reserve) and their names shall be removed from the register of shareholders; (b) Reserve shall become and be the sole shareholder of Fargo, its name shall be entered in the register of shareholders of Fargo as such, and it shall be entitled to receive a share certificate or certificates representing such shares of Fargo; (c) each certificate formerly representing shares of Fargo held by the former shareholders of Fargo (other than Reserve) shall thereafter represent: (i) in the case of a former shareholder of Fargo who does not dissent from the Arrangement, the right upon surrender of his certificate to Guaranty Trust Company of Canada, Calgary, Alberta, Canada, on or before July 31, 1968 (or such later date as is provided for in the Arrangement), and upon payment of all applicable transfer taxes and transfer fees, to require Guaranty Trust Company of Canada (1) to transfer to such holder the number of whole shares of Reserve Common Stock to which the holder is entitled under the terms of the Arrangement, and (2) to account to such holder for any fractional share of Reserve Common Stock to which such holder would be entitled under the terms of the Arrangement; and (ii) in the case of a former shareholder of Fargo who dissents from the Plan the right upon the surrender of his certificate to Guaranty Trust Company of Canada to receive from Fargo such award as may be made to such former shareholder by or as a result of any direction of the Supreme Court of Alberta in sanctioning the Plan.

Termination of Plan

The Plan may be terminated for various causes therein set forth, including, without limitation, the failure of either Reserve or Fargo to perform conditions precedent to consummation of the Plan or if the number of shares of Fargo effectively dissenting from the Plan shall exceed five per cent of the

outstanding shares of Fargo, or if the amount in cash or other consideration, if any, required by the Court to be given by Fargo to such effectively dissenting shareholders shall exceed certain percentages of fair market value of Fargo's assets, cash and readily realizable assets or such amount which, in Reserve's judgment, would so adversely affect Fargo's operations or financial position as to warrant the termination of the Plan. Reserve, however, may waive such rights of termination. In the event of termination of the Plan, neither party shall have any liability to the other.

Tax Status

Reserve, Fargo and a shareholder of Fargo have applied for rulings from the United States Internal Revenue Service (a) that under Section 367 of the Internal Revenue Code the exchange of Fargo shares for Reserve shares ". . . is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes", and (b) that under Sections 368(a)(1)(B) and 354(a)(1) of the Code, a Fargo shareholder will not, by reason of the exchange, recognize any gain or loss for United States federal income tax purposes, except with respect to any cash payment for a fraction of a share.

If an unfavorable ruling is received under Section 367 of the Internal Revenue Code, the exchange, in the opinion of Morrison, Foerster, Holloway, Clinton & Clark, counsel for Reserve, will be a taxable transaction; and a Fargo shareholder subject to United States income tax will have 1968 taxable income or loss in an amount equal to the difference between the tax basis of the Fargo stock surrendered and the fair market value on the Closing Date of the Reserve stock received; and, assuming the Fargo stock is a capital asset in the hands of the shareholder, his gain or loss will be taxable as long-term capital gain or loss if the holding period for his Fargo stock was more than six months and short-term capital gain or loss if the holding period for his Fargo stock was not more than six months. Based upon the large number of shareholders of Fargo from December 31, 1962 to date, it appears reasonable to conclude that Fargo has not been since that date, and will not be at the time of the exchange, a "Controlled Foreign Corporation" as that term is defined in Subpart F (Sections 951-964) of the Code, and, therefore, the special provisions of Section 1248 of the Code are not applicable to the exchange.

If a favorable ruling is received under Section 367 of the Internal Revenue Code but an unfavorable ruling received under Sections 368(a)(1)(B) and 354(a)(1) with respect to the tax-free aspect of the exchange, or if the application for such ruling be withdrawn in order to prevent an adverse ruling, the Fargo shareholder will not be precluded from contesting the taxability of the exchange before the Internal Revenue Service or in the courts; and in the opinion of said counsel for Reserve, such shareholder would have a reasonable chance for success.

The obtaining of such favorable ruling or rulings is not a condition to consummation of the Plan and the exchange contemplated thereby.

DESCRIPTION OF RESERVE OIL AND GAS COMPANY (THE "COMPANY" OR "RESERVE") AND OF FARGO OILS LTD. ("FARGO")

The capitalization of Reserve and Fargo, the business and properties of each, and other pertinent information, including remuneration of officers and directors, follows:

NOTE: *Unless otherwise indicated, all dollar figures with respect to Reserve are expressed in United States dollars, and all dollar figures with respect to Fargo are expressed in Canadian dollars. The Canadian dollar is presently selling at a discount of approximately 8% from the United States dollar.*

CAPITALIZATION

Capitalization Table

The following table sets forth the capitalization of the Company and Fargo at December 31, 1967, and their pro forma combined capitalization giving effect to the proposed exchange of Reserve shares for Fargo shares assuming all Fargo shareholders, other than Reserve, elect to exchange their shares. This table should be read in conjunction with its notes and with the pro forma combined condensed balance sheet and related notes included elsewhere in this Proxy Statement.

<u>Title</u>	<u>The Company</u>	<u>Fargo</u>	<u>Pro Forma Combined</u>
Debt:①			
The Company:			
Various secured and unsecured indebtedness.....	\$ 464,139②		\$ 464,139②
6½% Convertible Subordinated Debentures due December 15, 1992.....	14,000,000③		14,000,000③
Fargo:			
5% installment notes (unsecured).....		\$404,399④	404,399④
Capital Stock:			
The Company:			
Preferred Stock, par value \$25:			
Authorized	400,000 shs.		400,000 shs.
Outstanding:			
5½% Cumulative Convertible (Voting) Series A	28,600 shs.		28,600 shs.
5½% Cumulative Convertible (Voting) Series B	105,796 shs.⑤		105,796 shs.⑤
Common Stock, par value \$1:			
Authorized	15,000,000 shs.		15,000,000 shs.
Outstanding	4,512,587 shs.⑤⑥		7,185,307 shs.⑤⑥⑦
Fargo:			
Ordinary Common shares, par value \$1: (Authorized 9,000,000 shares)			
Outstanding		8,519,682 shs.⑧	⑧

NOTES:

- ① In all cases includes portion due within one year. See Note 7 to "Financial Statements—Reserve" for details with respect to the Company's debt.
- ② This amount consists of promissory notes secured by eight deeds of trust on improved and unimproved real property aggregating \$148,837 with interest ranging from 6% to 7.2%; a promissory note of \$116,400 with interest of 5½% secured by the Company's interest in a natural gasoline plant; two unsecured promissory notes aggregating \$43,333 at 6% interest; Cumulative 5½% Debentures, due October 15, 1971, aggregating \$139,400; and a City of Victorville, California, street assessment of \$16,169 at 6% interest; all of this debt ranks prior to the 6½% Convertible Subordinated Debentures. Reference is made to "Description of Debentures—Subordination" for information concerning future debt of the Company.
- ③ By February 29, 1968, \$2,096,000 in principal amount of these debentures had been retired by conversion thereof into 159,586 shares of Common Stock of Reserve.
- ④ Includes portion due within one year; payable in equal installments on the first day of July in each of the years 1968 to 1970.
- ⑤ Does not include 2,435 shares of Series B Preferred Stock and 20,387 shares of Common Stock, respectively, held in the treasury.
- ⑥ Does not include 341,806 shares of Common Stock reserved for issuance upon conversion of the Company's Series A and Series B Preferred Stock, 1,066,666 shares reserved for issuance upon conversion of the Company's 6½% Convertible Subordinated Debentures, due December 15, 1992, or 80,000 shares of Common Stock reserved for issuance upon exercise of stock options granted or to be granted.
- ⑦ Gives effect to the issuance of the maximum of 2,669,894 Common shares of the Company in exchange for all the Common shares of Fargo outstanding at December 31, 1967, assuming no Fargo shareholder dissents from the Plan; but does not include Common shares of the Company which may become outstanding after December 31, 1967, and prior to the Closing Date under the Plan in the event of the conversion of Series A Preferred Stock, Series B Preferred Stock, 6½% Convertible Subordinated Debentures, or exercise of outstanding stock options of the Company, but does give effect to the issuance of Common shares of the Company upon exercise of outstanding Fargo stock options. Assuming all shares of Series A Preferred Stock, Series B Preferred Stock and all Debentures of the Company were converted and all outstanding stock options of the Company exercised, 1,488,461 additional shares of Common Stock of the Company would be outstanding.
- ⑧ Does not include 2,826 shares subject to Fargo's stock option plan all of which were exercised prior to February 29, 1968. See Note 7 to "Financial Statements—Fargo."
- ⑨ All Fargo shares outstanding will be owned by the Company.

COMPARATIVE DATA

Range of Security Prices (in U.S.\$)

The following tabulation shows the price range of the Common Stocks of the Company and Fargo during the period January 1, 1963, through February 29, 1968. The prices shown for the Company through the third quarter of 1967 were on the Pacific Coast Stock Exchange; thereafter, on the American Stock Exchange, on which the Company's Common Stock commenced trading on August 29, 1967. The prices shown for Fargo through the entire period were on the American Stock Exchange.

	The Company		Fargo	
	High	Low	High	Low
1963	11 $\frac{1}{4}$	7 $\frac{3}{4}$	2 $\frac{7}{8}$	1 $\frac{7}{8}$
1964	8 $\frac{5}{8}$	5 $\frac{1}{2}$	3 $\frac{3}{8}$	2 $\frac{1}{8}$
1965	9 $\frac{1}{2}$	5 $\frac{1}{4}$	3 $\frac{5}{8}$	2 $\frac{1}{4}$
1966				
1st quarter	8 $\frac{1}{8}$	6 $\frac{7}{8}$	3 $\frac{3}{8}$	2 $\frac{5}{8}$
2nd quarter	7	5 $\frac{3}{4}$	3 $\frac{5}{8}$	2 $\frac{5}{8}$
3rd quarter	5 $\frac{7}{8}$	4 $\frac{3}{4}$	3 $\frac{1}{2}$	2 $\frac{1}{2}$
4th quarter	5 $\frac{3}{8}$	4 $\frac{1}{4}$	3	2 $\frac{1}{4}$
1967				
1st quarter	7 $\frac{1}{4}$	4 $\frac{3}{4}$	3 $\frac{3}{8}$	2 $\frac{5}{8}$
2nd quarter	8 $\frac{1}{4}$	6 $\frac{1}{2}$	5 $\frac{9}{16}$	2 $\frac{15}{16}$
3rd quarter	10 $\frac{1}{4}$	7	5 $\frac{1}{8}$	3 $\frac{5}{16}$
4th quarter	14 $\frac{3}{8}$	9	7 $\frac{5}{8}$	3 $\frac{11}{16}$
1968 (through February 29)....	19 $\frac{3}{4}$	13 $\frac{1}{8}$	7 $\frac{5}{8}$	5 $\frac{1}{4}$

Earnings Per Share

Reserve's historical earnings per share have been computed on the weighted average number of its shares of common stock outstanding during 1967 (this number being not significantly different from the equivalent number of shares outstanding at other dates during the periods shown, after allowance for shares issued in connection with companies acquired on the basis of poolings-of-interests). Fargo's historical earnings per share have been computed on the number of its shares outstanding at the end of the respective periods.

Pro forma earnings per share of the combined companies are based on the earnings shown in the pro forma combined statement of income, and on the numbers of shares indicated in Note ② below. The pro forma combined earnings per share attributable to each share of Fargo stock are based on an exchange of each such share for .43 shares of Reserve's common stock, as described elsewhere herein.

Reserve①④:	1963	1964	1965	1966	1967
Historical:					
Income before extraordinary items:					
Amount attributable to production payment income⑥....	\$.05	\$.20	\$.16	\$.26	\$.31
Other	.03	(.07)	.14	.08	.03
Total	.08	.13	.30	.34	.34
Extraordinary items	.03	.10	.15	.02	.05
Net income	.11	.23	.45	.36	.39
Pro forma combined②⑤:					
Income before extraordinary items (including production payment income)	.10	.14	.26	.29	.31
Extraordinary items	.02	.06	.09	.02	.03
Net income	.12	.20	.35	.31	.34
Pro forma combined—adjusted③⑤⑥:					
Income before extraordinary items (including production payment income)					\$.20
Extraordinary items					.03
Net income					.23

Fargo:	1963	1964	1965	1966	1967
Historical net income (Canadian dollars):					
Amount attributable to production payment income (Fargo's Note 3)	\$.09	\$.09	\$.10	\$.10	\$.11
Other	(.03)	(.02)	(.02)	—	—
Total	.06	.07	.08	.10	.11
Pro forma combined attributable to .43 shares of Reserve's common stock ^{①②③④⑤} :					
Income before extraordinary items (including produc- tion payment income)	.04	.06	.11	.12	.14
Extraordinary items	.01	.03	.04	.01	.01
Net income	.05	.09	.15	.13	.15
Pro forma combined—adjusted—attributable to .43 shares of Reserve's common stock ^{①②③④⑤} :					
Income before extraordinary items (including produc- tion payment income)					\$.09
Extraordinary items					.01
Net income					.10

NOTES:

- ① See Note (e) to Reserve's Statement of Income, elsewhere herein, for information concerning deductions for preferred stock dividends.
- ② Computed on the weighted average number of shares of Reserve's common stock outstanding during 1967 (this number being not significantly different from the equivalent number of shares outstanding at other dates during the periods shown, after allowance for shares issued in connection with companies acquired on the basis of poolings-of-interests); plus 2,669,894 shares which would be received by Fargo shareholders (other than Reserve) assuming they all elect to exchange their shares; and after appropriate deduction for annual dividends on Reserve's preferred stocks. There would have been no material effect on pro forma net income per share if all convertible preferred stocks and debentures outstanding at December 31, 1967 had been converted in 1967 (and outstanding stock options had been exercised).
- ③ Assumes (a) full year's interest on the convertible debentures, (b) full year's amortization of the excess of Reserve's cost over Fargo's book value of the 27.1% interest in Fargo purchased by Reserve at the beginning of September 1967, and (c) elimination of the 27.1% minority interest at the beginning of 1967.
- ④ No dividends have been paid by either Reserve or Fargo on their common stock. Reference is made to Note 7 to Reserve's financial statements included elsewhere herein for information on dividend restrictions.
- ⑤ See Note 3 to the pro forma combined condensed balance sheet shown elsewhere herein for information concerning combination of Fargo's financial statements expressed in Canadian dollars with Reserve's financial statements expressed in United States dollars.
- ⑥ See Statement of Income—Reserve (note (b)), elsewhere herein, for information concerning Reserve's method of accounting for proceeds from the sale of production applied to production payments retained by others.

At December 31, 1967, the Company had an operating loss carryforward of approximately \$1,500,000 which may be utilized to offset taxable income as follows: \$1,500,000 through 1968, \$900,000 through 1969 and \$60,000 through 1970.

At December 31, 1967, Fargo had accumulated unrecovered development and exploration costs of approximately \$1,413,000 (including \$327,000 which can only be applied against future income of properties acquired by Fargo in 1958 from Siebens Producers Ltd.) which, for Canadian income tax purposes, may be applied against future income to reduce or eliminate income taxes payable. In addition Fargo has \$8,710,863 of Capital Cost Allowance which may thereafter be applied in further reduction or elimination of income taxes payable, at rates ranging from 4% to 30% of remaining balance of cost, depending upon the class of property involved. At December 31, 1967 \$2,191,000 of such Capital Cost Allowance was available to Fargo. At December 31, 1967, Fargo also had loss carry forward of \$270,563, which can only be deducted from income after elimination of all development and exploration costs.

Book Values Per Share

The following tabulation shows the book values of Reserve's shares of common stock and Fargo's ordinary common shares at December 31, 1967 on both an historical and a pro forma basis.

	Per Share
Reserve:	
Historical	\$4.17
Pro forma assuming conversion of all outstanding preferred stocks and convertible debentures, and exercise of all outstanding stock options	6.04
Fargo—historical (Canadian dollars)③.....	1.48
Reserve and Fargo combined①②③:	
Pro forma without conversion of outstanding preferred stocks and convertible debentures, or exercise of outstanding stock options:	
As to each share of Reserve's common stock.....	4.09
As to each share of Fargo's stock (the equivalent of .43 shares of Reserve's stock).....	1.76
Pro forma assuming conversion of all outstanding preferred stocks and convertible debentures, and exercise of all outstanding stock options:	
As to each share of Reserve's common stock.....	5.23
As to each share of Fargo's stock (the equivalent of .43 shares of Reserve's stock)	2.25

NOTES:

- ① Assuming all Fargo shareholders (other than Reserve) elect to exchange their shares for Reserve's common stock.
- ② Based on the common stockholders' equity shown in the pro forma combined balance sheet elsewhere herein.
- ③ See note 3 to the pro forma combined balance sheet shown elsewhere herein concerning combination of United States and Canadian dollar amounts.

Comparison of Hydrocarbon Reserves

	At December 31, 1967		
	The Company① Actual	Fargo② Actual	Pro Forma Combined
Total proved developed			
Crude Oil, Condensate and Natural Gas Liquids, Barrels	14,516,873	18,926,854	33,443,727
Natural Gas, Mcf	80,314,299	111,474,455	191,788,754
Sulphur, Long Tons	—	980,216	980,216
Total proved undeveloped			
Crude Oil, Condensate and Natural Gas Liquids, Barrels	127,392	—	127,392
Natural Gas, Mcf	7,166,720	20,398,597③	27,565,317④
Sulphur, Long Tons	—	—	—
Grand total—proved reserves			
Crude Oil, Condensate and Natural Gas Liquids, Barrels	14,644,265	18,926,854	33,571,119
Natural Gas, Mcf	87,481,019	131,873,052③	219,354,071④
Sulphur, Long Tons	—	980,216	980,216

NOTES:

- ① See letter of James A. Lewis Engineering, Inc., included elsewhere herein, which presents an analysis of the future recoverable hydrocarbons from the properties of the Company.
- ② See letter of James A. Lewis Engineering Co., Ltd., included elsewhere herein, which presents an analysis of the future recoverable hydrocarbons from the properties of Fargo.
- ③ Consists of shut-in proved developed gas reserves located in British Columbia.
- ④ Includes shut-in reserves referred to in Note ③.

It is estimated that an additional capital expenditure of \$84,175 will be required to permit recovery of the total proved undeveloped reserves of the Company, and \$1,260,300 to permit recovery of the total proved undeveloped reserves of Fargo.

STATEMENT OF INCOME—RESERVE

The following statement of income of the Company for the five years ended December 31, 1967, which has been prepared on the basis outlined in Note (a) below, has been examined by Arthur Young & Company, certified public accountants, whose report thereon (which is based in part on the reports of other certified public accountants) appears elsewhere in this Proxy Statement. This statement should be read in conjunction with the other financial statements and related notes of the Company appearing elsewhere in this Proxy Statement.

	Years Ended December 31,				
	1963	1964	1965	1966	1967
Revenues:					
Sales of petroleum products.....	\$3,432,312	\$5,743,221	\$ 5,616,704	\$ 6,828,001	\$ 7,307,777
Sales of real estate (h)	919,137	1,463,489	1,939,026	1,773,280	1,344,100
Commission income (h)	1,650,349	1,681,703	1,576,320	1,815,346	1,654,239
Interest and dividend income.....	513,098	465,468	508,685	517,596	486,915
Other income	215,643	104,476	627,759	409,723	528,895
	<u>6,730,539</u>	<u>9,458,357</u>	<u>10,268,494</u>	<u>11,343,946</u>	<u>11,321,926</u>
Costs and expenses:					
Oil and gas and other operating expenses.....	1,444,642	2,143,845	2,315,867	3,138,906	3,537,922
Cost of real estate sold	99,580	146,629	318,648	249,698	291,281
Provision for loss on repossessions	402,809	313,240	254,930	451,469	418,048
Selling and administrative expenses.....	1,307,594	1,819,593	1,491,699	1,757,275	1,705,670
Dry hole costs	343,925	25,209	20,163	65,529	28,961
Depletion, depreciation, and abandonments.....	1,384,698	2,266,115	2,177,307	2,442,258	2,452,585
Interest expense	476,318	1,373,006	1,368,993	1,265,720	1,179,823
Federal income taxes (g).....	712,064	597,390	775,171	281,063	11,830
	<u>6,171,630</u>	<u>8,684,937</u>	<u>8,722,778</u>	<u>9,651,918</u>	<u>9,626,120</u>
Income before extraordinary items.....	558,909	773,420	1,545,716	1,692,028	1,695,806
Extraordinary items (c) :					
Federal income tax reduction attributable to loss carry-forwards	—	—	—	111,000	228,000
Gain on sales of securities.....	—	—	661,433	—	—
Gain on sales of oil and gas properties.....	—	449,651	—	—	—
Gain on sale of broadcasting station, net of \$44,074 federal income tax	132,224	—	—	—	—
Net income (a) (b).....	<u>\$ 691,133</u>	<u>\$1,223,071</u>	<u>\$ 2,207,149</u>	<u>\$ 1,803,028</u>	<u>\$ 1,923,806</u>
Per share of common stock (d) (e) (f) :					
Income before extraordinary items, allocable to common stock:					
Amount attributable to production payment income(b) ..	\$.05	\$.20	\$.16	\$.26	\$.31
Other	.03	(.07)	.14	.08	.03
Total	.08	.13	.30	.34	.34
Extraordinary items	.03	.10	.15	.02	.05
Net income allocable to common stock.....	<u>\$.11</u>	<u>\$.23</u>	<u>\$.45</u>	<u>\$.36</u>	<u>\$.39</u>

No cash dividends have been paid on the Company's common stock.

NOTES:

- (a) Reference is made to the notes to the Company's financial statements included elsewhere herein for information on the following:
 - (1) Poolings-of-interests with Fremont Valley Lands, Inc., Rice Ranch Oil Company, Apple Valley Building and Development Company, and Long Beach Dock and Terminal Company—note 1.
 - (2) Sales of land—note 3.
 - (3) Commission income—note 4.
 - (4) Federal and state income taxes—note 8.
- (b) The proceeds from the sale of production applied to production payments retained by others (see note 2 to the Company's financial statements shown elsewhere herein) are recorded as earnings of the Company subject to production taxes, charges for depletion and depreciation, and interest accruing on the production payments. The effect of adopting this method of accounting for production attributable to the production payments, as opposed to an alternative method under which such production, revenues, and expenses would not be reflected in the Company's financial statements, has been to increase reported revenues and expense by the following amounts:

(Notes continued on following page)

	Years Ended December 31,				
	1963	1964	1965	1966	1967
Oil and gas sales	\$1,022,000	\$3,160,000	\$3,181,000	\$3,668,000	\$3,818,000
Gain on sales of oil and gas properties	—	343,000	(11,000)	—	—
Production taxes	47,000	151,000	143,000	154,000	155,000
Depletion and depreciation.....	325,000	1,225,000	1,200,000	1,320,000	1,400,000
Interest	424,000	1,248,000	1,117,000	1,016,000	853,000
	<u>796,000</u>	<u>2,624,000</u>	<u>2,460,000</u>	<u>2,490,000</u>	<u>2,408,000</u>
Increase in net income.....	\$ 226,000	\$ 879,000	\$ 710,000	\$1,178,000	\$1,410,000
Income per share attributable to production payment income	\$.05	\$.20	\$.16	\$.26	\$.31

The amounts included in the above table do not include lifting costs related to the production payment properties; such costs would be charged against income under either of the above-mentioned methods of accounting. Accumulated net income credited to earned surplus has been increased by \$4,403,000 as a result of adopting this method of accounting.

The Company does not expect to incur federal income tax on this income, since it expects it to be offset for tax purposes by future intangible drilling costs and allowances for percentage depletion. Accordingly, no provision is being made at this time for related federal income tax.

- (c) No provision has been made for income tax on the gains on sales of securities and oil and gas properties due to losses for tax purposes from oil and gas operations in the applicable years, and the loss carryforward mentioned in note 8 to the Company's financial statements included elsewhere herein. The sale of the broadcasting station was made by a subsidiary of Apple Valley Building and Development Company.
- (d) Per share amounts have been computed on the weighted average number of shares of the Company's common stock outstanding during 1967. This number of shares outstanding is not significantly different from the equivalent number of shares outstanding at other dates during the subject periods, after allowance for shares issued in connection with companies acquired on the basis of poolings-of-interests.
- (e) Income before extraordinary items, and net income, have been reduced, for the purpose of computing amounts per share of common stock, by the annual preferred dividends of \$187,463 that would have been paid or payable on the Series A and Series B 5½% preferred stock issued in connection with the Rice Ranch, Apple Valley, and Long Beach acquisitions. There would have been no dilution of pro forma net income per share if all convertible preferred stocks and debentures outstanding at December 31, 1967 had been converted in 1967 (and outstanding stock options had been exercised).
- (f) For restrictions on payments of dividends, see note 7 to the Company's financial statements included elsewhere herein. The Company has not paid cash dividends on its common stock.
- (g) Included in the provisions for federal income taxes are charges of the following amounts for deferred taxes relating to Apple Valley operations: 1962—\$151,000; 1963—\$59,000; 1964—\$121,000; and 1965—\$95,000. Also included in the provision are credits of the following amounts for reduction of deferred taxes relating to Fremont Valley operations: 1962—\$23,000; 1963—\$13,000; 1964—\$163,000; 1965—\$204,000; and 1967—\$221,568.
- (h) For information concerning decline in gross sales of property during 1967 see "Description of Business and Properties of the Company—Commercial and Residential Real Property and Other Activities," elsewhere herein.

In December 1967 Reserve issued \$14,000,000 of 6½% convertible subordinated debentures, due December 15, 1992. The annual interest requirement on the full amount of the debentures would be approximately \$910,000. The proceeds from the sale of the debentures were used to repay bank indebtedness on which the interest requirement on an annualized basis would be approximately \$850,000. Expense of the issue amounted to approximately \$524,000, amortization of which for a full year would be approximately \$26,000.

The Company estimates that \$1,344,000 of the issue price of the debentures was attributable to the conversion feature. The Company has elected not to make such an allocation pending clarification of the appropriate accounting treatment for convertible debt securities. Such clarification, expected in 1968, may require that the principles be applied retroactively. In the event of such an allocation the annual amortization of the amount attributable to the conversion feature is not in any event expected to be material.

Since December 31, 1967 Reserve has carried on business in the ordinary course and there has been no material change in the financial position of Reserve, except for the conversion in January and February 1968 of debentures with a principal amount of \$2,096,000 into 159,586 shares of Reserve's Common Stock.

STATEMENT OF INCOME—FARGO

(Stated in Canadian dollars)

The following statement of income of Fargo Oils Ltd. for the five years ended December 31, 1967 has been examined by Peat, Marwick, Mitchell & Co., chartered accountants, whose report thereon appears elsewhere in this Proxy Statement. This statement should be read in conjunction with the other financial statements and related notes of Fargo appearing elsewhere in this Proxy Statement.

	Year Ended December 31				
	1963	1964	1965	1966	1967
Income:					
Oil revenue less royalties.....	\$1,786,915	2,220,134	2,796,197	3,187,012	3,554,835
Royalties (A)	512,756	311,758	81,272	88,728	87,741
	<u>2,299,671</u>	<u>2,531,892</u>	<u>2,877,469</u>	<u>3,275,740</u>	<u>3,642,576</u>
Direct expenses (exclusive of depreciation and depletion) :					
Operating expenses	478,828	515,031	679,275	810,588	883,806
Non-producing lease rentals.....	109,110	139,040	121,272	152,094	146,067
Dry holes and abandonments.....	158,400	181,743	234,638	95,594	213,905
Permits and leases surrendered.....	10,206	19,605	17,225	66,578	50,275
	<u>756,544</u>	<u>855,419</u>	<u>1,052,410</u>	<u>1,124,854</u>	<u>1,294,053</u>
Depreciation and depletion (Note 3) :					
Depreciation	79,815	86,843	85,726	95,904	72,430
Depletion of producing gas and oil properties.....	678,123	697,284	548,413	674,684	684,845
	<u>757,938</u>	<u>784,127</u>	<u>634,139</u>	<u>770,588</u>	<u>757,275</u>
General and administrative expenses.....	219,068	227,147	262,979	279,249	327,102
	<u>566,121</u>	<u>665,199</u>	<u>927,941</u>	<u>1,101,049</u>	<u>1,264,146</u>
Other income:					
Interest income	92,186	71,243	66,016	38,216	33,315
Miscellaneous—net	21,628	13,650	414	7,630	13,440
	<u>113,814</u>	<u>84,893</u>	<u>66,430</u>	<u>45,846</u>	<u>46,755</u>
	<u>679,935</u>	<u>750,092</u>	<u>994,371</u>	<u>1,146,895</u>	<u>1,310,901</u>
Other charges:					
Interest on unpaid production payments.....	124,935	129,898	224,648	281,084	337,501
Amortization of financing expenses.....	1,476	1,476	6,401	—	—
Interest on notes payable.....	50,523	43,782	37,042	30,302	23,562
Miscellaneous—net	2,110	—	26,044	13,961	8,074
	<u>179,044</u>	<u>175,156</u>	<u>294,135</u>	<u>325,347</u>	<u>369,137</u>
Net income (B) (Note 3).....	<u>\$ 500,891</u>	<u>574,936</u>	<u>700,236</u>	<u>821,548</u>	<u>941,764</u>
Net income per share (based on shares outstanding at end of respective periods) :					
Amount attributable to production payment income (Note 3)	\$.09	.09	.10	.10	.11
Other	(.03)	(.02)	(.02)	—	—
Total	<u>\$.06</u>	<u>.07</u>	<u>.08</u>	<u>.10</u>	<u>.11</u>

No cash dividends have been paid on the common shares of Fargo.

- (A) Royalties were reduced after 1963 due to termination of Pembina Royalty. This royalty contributed approximately \$400,000 for 1963 and \$200,000 for 1964. Depletion expense was reduced during these years relative to the reduction in royalty income.
- (B) No provision has been made for taxes on income since the company has expended more than sufficient amounts on drilling and exploration costs which may, for income tax purposes, be applied against the reported earnings so that there are no income taxes payable.
- (C) See note 1 of notes to Fargo's financial statements regarding elimination of \$10,751,281 of deficit through an appropriation from paid-in surplus as of December 31, 1962.
- (D) Numerical note references are to the notes to Fargo's financial statements included elsewhere herein.

Since December 31, 1967, Fargo has carried on business in ordinary course and there has been no material change in the financial position of Fargo.

PRO FORMA COMBINED STATEMENT OF INCOME (Unaudited)

The following pro forma statement combines the operating results of Reserve and Fargo for the five years ended December 31, 1967 on the basis of a pooling-of-interests (except for the 27.1% interest in Fargo purchased by Reserve—Note ① below) and should be read in conjunction with the financial statements and related footnotes of the respective companies included elsewhere herein.

	Years Ended December 31,				
	1963	1964	1965	1966	1967
Revenues:					
Sales of petroleum products.....	\$5,731,983	\$ 8,275,113	\$ 8,494,173	\$10,103,741	\$10,950,353
Sales of real estate.....	919,137	1,463,489	1,939,026	1,773,280	1,344,100
Commission income	1,650,349	1,681,703	1,576,320	1,815,346	1,654,239
Interest and other income.....	842,555	654,837	1,202,874	973,165	1,062,565
	<u>9,144,024</u>	<u>12,075,142</u>	<u>13,212,393</u>	<u>14,665,532</u>	<u>15,011,257</u>
Costs and expenses:					
Operating and interest expenses④....	6,869,771	9,669,527	9,617,692	11,169,726	11,739,195
Cost of real estate sold.....	99,580	146,629	318,648	249,698	291,281
Provision for loss on reposessions....	402,809	313,240	254,930	451,469	418,048
Federal income taxes.....	712,064	597,390	775,171	281,063	11,830
	<u>8,084,224</u>	<u>10,726,786</u>	<u>10,966,441</u>	<u>12,151,956</u>	<u>12,460,354</u>
Income before minority interest and extraordinary items④	1,059,800	1,348,356	2,245,952	2,513,576	2,550,903
Minority interest	135,741	155,808	189,764	222,640	170,145
Income before extraordinary items.....	924,059	1,192,548	2,056,188	2,290,936	2,380,758
Extraordinary items	132,224	449,651	661,433	111,000	228,000
Net income④⑥	<u>\$1,056,283</u>	<u>\$ 1,642,199</u>	<u>\$ 2,717,621</u>	<u>\$ 2,401,936</u>	<u>\$ 2,608,758</u>
Pro forma income per share⑤:					
Income before extraordinary items....	\$.10	\$.14	\$.26	\$.29	\$.31
Extraordinary items	.02	.06	.09	.02	.03
Net income	<u>\$.12</u>	<u>\$.20</u>	<u>\$.35</u>	<u>\$.31</u>	<u>\$.34</u>
Pro forma income—adjusted— per share⑥:					
Income before extraordinary items..					\$.20
Extraordinary Items					.03
Net income					<u>\$.23</u>

NOTES:

- ① The minority interest shown above represents the pro forma combined income allocable to Reserve's purchased 27.1% interest in Fargo for each of the years 1963 through 1966, and for eight months (until Reserve's purchase thereof) in 1967.
- ② See note 3 to the pro forma combined condensed balance sheet shown elsewhere herein for information concerning combination of Fargo's financial statements expressed in Canadian dollars with Reserve's financial statements expressed in United States dollars.
- ③ Per share amounts have been calculated on the weighted average number of shares of Reserve's common stock outstanding during 1967 (this number being not significantly different from the equivalent number of shares outstanding at other dates during the periods shown, after allowance for shares issued in connection with companies acquired on the basis of poolings-of-interests), plus 2,669,894 shares which would be received by Fargo shareholders (other than Reserve) assuming they all elect to exchange their shares; and after appropriate deduction of \$187,684 for annual dividends on Reserve's preferred stocks. There would have been no dilution of pro forma net income per share if all convertible preferred stocks and debentures outstanding at December 31, 1967 had been converted in 1967 (and outstanding stock options had been exercised).
- ④ 1967 includes amortization of the excess of Reserve's cost over Fargo's book value of the 27.1% interest in Fargo from the date of acquisition at the beginning of September to December 31, 1967 (\$86,667).
- ⑤ Assumes (a) full year's interest of \$720,915 on \$11,091,005 of convertible debentures, the proceeds from the sales of which were used to retire debt incurred to acquire a 27.1% interest in Fargo, (b) full year's amortization of the excess of Reserve's cost over Fargo's book value of the 27.1% interest in Fargo purchased by Reserve at the beginning of September 1967, \$260,000, and (c) elimination of the 27.1% minority interest at the beginning of 1967.
- ⑥ Reference is made to Note 7 to Reserve's financial statements included elsewhere herein for information on dividend restrictions.

PRO FORMA COMBINED CONDENSED BALANCE SHEET (Unaudited)

The following unaudited pro forma condensed balance sheet combines the balance sheets of Reserve and Fargo at December 31, 1967, as described in the Notes below. This balance sheet should be read in conjunction with each of the two companies' separate financial statements and related Notes appearing elsewhere in this Proxy Statement.

Assets

	Reserve Oil and Gas Company	Fargo Oils Ltd.	Pro Forma Adjustments (Note 1)	Pro Forma Combined
Current assets:				
Cash	\$ 4,188,099	\$ 455,475	\$ —	\$ 4,643,574
Other current assets	5,352,711	785,218	—	6,137,929
Total current assets	9,540,810	1,240,693	—	10,781,503
Investments and long-term receivables:				
Installment receivables and other assets.....	4,365,862	112,859	5,320 ^(A)	4,484,041
Commissions receivable	3,437,734	—	—	3,437,734
Investment in Fargo Oils Ltd.	11,091,005	—	(11,091,005) ^(A)	—
Investment in subsidiary company	375,000	—	—	375,000
Undeveloped land—cost	928,612	—	—	928,612
Total investments and long-term receivables.....	20,198,213	112,859	(11,085,685)	9,225,387
Net properties	15,650,145	12,011,322	{ 7,760,000 ^(A) (86,667) ^(C)	35,334,800
Deferred charge	523,104	—	(78,316) ^(D)	444,788
	<u>\$45,912,272</u>	<u>\$13,364,874</u>	<u>\$(3,490,668)</u>	<u>\$55,786,478</u>

Liabilities and Shareholders' Equity

Current liabilities	\$2,351,164	\$ 516,067	\$ —	\$ 2,867,231
Long-term liabilities:				
Debentures	14,000,000	—	(2,096,000) ^(D)	11,904,000
Deferred taxes	4,405,000	—	—	4,405,000
Other	534,901	269,599	—	804,500
Total long-term liabilities	18,939,901	269,599	(2,096,000)	17,113,500
Deferred Income	2,449,000	—	—	2,449,000
Shareholders' equity:				
Capital stock:				
Preferred	3,420,775	—	—	3,420,775
Common	4,532,974	8,519,682	{ (2,310,626) ^(A) (6,209,056) ^(B) 2,669,894 ^(B) 159,586 ^(D) (135,741) ^(A)	7,362,454
Capital surplus	2,686,749	500,889	{ 3,539,162 ^(B) 1,858,098 ^(D) (879,318) ^(A) (86,667) ^(C)	8,449,157
Earned surplus	11,617,692	3,558,637	—	14,210,344
Treasury stock	(85,983)	—	—	(85,983)
Total shareholders' equity	22,172,207	12,579,208	(1,394,668)	33,356,747
	<u>\$45,912,272</u>	<u>\$13,364,874</u>	<u>\$(3,490,668)</u>	<u>\$55,786,478</u>

NOTES:

- Assumes all Fargo shareholders (other than Reserve) elect to exchange their shares for Reserve's common stock, resulting in the issuance of 2,669,894 shares of Reserve's common stock in exchange for 6,209,056 common shares of Fargo, as described elsewhere in this Proxy Statement. For accounting purposes, Reserve's acquisition of its 27.1% interest in Fargo has been treated as a purchase as from the date thereof—September 7, 1967—, and its proposed acquisition of the remainder of Fargo's outstanding stock has been treated as a pooling-of-interests. Accordingly, in consolidation:

(Notes continued on following page)

(Notes continued from preceding page)

- Ⓐ the cost of Reserve's 27.1% interest in Fargo (\$11,091,005) has been allocated to the underlying assets, with the excess (approximately \$7,765,000) of Reserve's cost over Fargo's book values being allocated substantially to developed properties (approximately \$6,210,000) and undeveloped properties (approximately \$1,550,000) on the basis of the independent appraisal made in January, 1968 by James A. Lewis Engineering Co., Ltd., and proportionate elimination of 27.1% of Fargo's stockholders' equity accounts for a total of \$3,325,685;
 - Ⓑ the remaining balance of \$6,209,056 in Fargo's capital account has been eliminated by credit of \$2,669,894 to Reserve's common stock account and \$3,539,162 to consolidated capital surplus;
 - Ⓒ provision has been made for amortization in 1967 of Reserve's cost of its 27.1% interest in Fargo in excess of Fargo's book value thereof. Substantially the whole of this excess cost was allocated to oil and gas properties for amortization on the unit-of-production basis, from the date of acquisition at the beginning of September 1967; and
 - Ⓓ effect has also been given to the conversion in January and February, 1968 of debentures in a principal amount of \$2,096,000 into 159,586 shares of Reserve's common stock, with a charge to capital surplus of \$78,316 for related debt expense.
- 2. No provision has been made for expenses connected with the exchange offer as they are not expected to be significant in relation to the pro forma combined balance sheet.
 - 3. Fargo's financial statements are expressed in Canadian dollars, which have been considered at par with the United States dollar for purposes of the pro forma combined financial statements shown herein. Differences resulting from application of appropriate exchange rates would not be material in relation to the pro forma combined balance sheet or statement of income.
 - 4. Reference is made to Note 7 to Reserve's financial statements included elsewhere herein for information on dividend restrictions.

DIVIDEND POLICIES

Neither the Company nor Fargo has paid or declared any cash dividends on its Common Stock. The Company and Fargo, each has the policy to retain earnings since capital requirements of each is expected to be significant. This policy with respect to Fargo may have to be modified in the future, if the Plan is consummated, by reason of Executive Order No. 11387 regulating Foreign Direct Investments of corporations resident of or doing business in the United States (such as Reserve). Reserve has regularly paid dividends on its Series A and Series B Preferred Stock. See "Description of Securities of Reserve"—"Description of Debentures" for limitations on dividends on the Company's Common Stock.

DESCRIPTION OF BUSINESS AND PROPERTIES OF THE COMPANY

General

Reserve Oil and Gas Company is a California corporation with executive offices located at 550 South Flower Street, Los Angeles, California. The Company's business is diversified, consisting primarily of oil and gas operations and real property development. The Company was incorporated in 1932 and has engaged in the exploration for and development of oil and gas since its inception. Since 1963, it has expanded its natural resources operations in both the United States and Canada and has entered other fields of operation.

In September, 1963, the Company acquired significant oil and gas interests, subject to production payments, located in the United States Mid-Continent area from Producing Properties, Inc., thus greatly increasing its proven oil and gas reserves. In April, 1964, the Company first became associated with California real property development through the purchase of the assets of Fremont Valley Lands, Inc., a company holding obligations secured by real property, as well as certain oil and gas interests.

In May, 1965, the assets of Rice Ranch Oil Company, consisting of California oil and gas interests, undeveloped real property located near Santa Maria, California, and marketable securities, were acquired by the Company. In the same year, the Company completed the construction of a plant at Hanford, California, for the production of anhydrous ammonia, a commercial fertilizer. In 1965, the Company also purchased significant gas producing properties in the Vernalis Gas Field in California.

In the spring of 1966, the Company concluded its largest acquisitions to date with the acquisition of the assets of Apple Valley Building and Development Company and of Long Beach Dock and Terminal Company. The major asset of Apple Valley consisted of fee title to approximately 9,600 acres of land in Apple Valley, California, a community located in the "upper desert" area of Southern California which has been developed almost exclusively by the Company and its predecessor. The Apple Valley assets also included interests in contracts evidencing the prior sale of real property in that area. The interests acquired from Long Beach Dock and Terminal Company included commercial warehousing facilities in the City of Long Beach, California, and oil interests in the Wilmington Field in the Long Beach harbor area.

The Company's most recent acquisition (September 1967) was 27.1% of the outstanding stock of Fargo Oils Ltd

Prior to 1964, 100% of the net profit of the Company was derived from the production of oil and gas and other oil and gas activities. For the year 1967, the approximate percentages of gross revenues of the Company allocable to its primary areas of activity (including gross revenues from oil and gas properties subject to production payment, see Note (b) to "Statement of Income—Reserve") were: for oil and gas operations, 57%; for real estate sales and brokerage, 29%; and for miscellaneous activities, 14%. The percentages of pre-tax income allocable to these activities during 1967 were approximately as follows: oil and gas operations 38%, real estate sale and brokerage 59%, and miscellaneous activities 3%. (See "Statement of Income—Reserve" for a more detailed presentation of the Company's operating results.)

The annual interest requirement on the Company's Debentures, issued as of December 15, 1967, is \$777,335 (based on Debentures outstanding on February 15, 1968). Expense of the issue was approximately \$523,977; amortization thereof in the first full year is estimated to be \$26,500.

The Company estimates that \$1,344,000 of the issue price of the debentures is applicable to the conversion feature, but does not presently propose to provide for amortization thereof; the annual charge for which is not in any event expected to be material.

The annual dividend requirement on the Company's Series A and Series B Preferred Stock is \$185,617 (based on number of Preferred shares outstanding on February 15, 1968).

It is the present intention of management to maintain the Company's primary interests in oil and gas operations and real property development, but to pursue any opportunities for continued diversification of its business when management considers such opportunities attractive.

Oil and Gas

Western United States Operations

From the date of its incorporation in 1932, the Company has been engaged in the business of developing and producing oil and gas in California and has conducted exploratory operations in several other western states. Until the acquisition of certain assets from Producing Properties, Inc. (see "*Mid-Continent Operations*"), the Company's principal producing operations were centered in the Tejon area, Kern County, California, on lands in which the Company has owned an interest since its organization.

In May, 1965, the Company acquired the assets, subject to the liabilities, of Rice Ranch Oil Company, a California corporation ("Rice Ranch"), in exchange for 32,000 shares of its 5½% Series A Preferred Stock and 215,000 shares of its Common Stock. The assets of Rice Ranch consisted primarily of approximately 813 acres of land located five miles southeast of Orcutt, and near Santa Maria, California. Approximately 727 acres of this land were owned in fee, of which 100 acres were developed and actively producing oil and gas, and 627 acres were held for possible deep oil production and real estate development. Approximately 47 acres of land were undeveloped and owned in fee without mineral rights, but with the right of first refusal on any offer to sell or lease the mineral rights. The Company also acquired from Rice Ranch a lease of 5/6ths of the mineral rights on 40 acres, as well as marketable securities with an aggregate quoted market value of \$1,207,228 on December 31, 1964. The Company sold these securities in the open market at an aggregate price in excess of such market value.

Since its acquisition of Rice Ranch, the Company has continued operation of the producing properties. As of December 31, 1967, there were 19 producing wells on the Rice Ranch property which were owned in full by the Company. The average daily net production during 1967 from these wells was 74 barrels of oil and 339 Mcf of gas.

In December, 1965, the Company purchased interests in the Vernalis Gas Field, San Joaquin County, California, for approximately \$770,000 in cash, subject to production payments of approximately \$340,000. These properties include working interests ranging from 12½% to 25% on an aggregate of 2,994 gross acres. As of December 31, 1967, the Company owned interests in 19 producing gas wells, or 4.27 net wells, on these properties, and the average daily gas production net to the Company's interests during 1967 was 1,683 Mcf per day. This gas is sold under long-term contractual arrangements at a price of 29 cents per Mcf.

In March, 1966, the Company acquired the assets, subject to the liabilities, of Long Beach Dock and Terminal Company ("Long Beach Dock") in exchange for 338,028 shares of Common Stock and 44,739 shares of 5½% Series B Preferred Stock. The assets of Long Beach Dock included oil interests in the Wilmington Oil Field and improved real property, both in the harbor area of Long Beach, California. (With respect to these real properties, see "Other Commercial Properties".) From the oil interests so acquired, the average daily production net to the Company's interests during 1967 was 338 barrels of oil.

The Company also owns various other oil and gas interests in the Western United States, none of which, individually, is material in relation to the assets or financial position of the Company.

Mid-Continent Operations

On September 1, 1963, the Company purchased from Producing Properties, Inc. working interests in 1,657 gross producing wells, or 283 net oil wells, and 44 net gas wells, together with certain non-producing properties located in 14 states in the Mid-Continent area of the United States. The Company purchased these properties for \$2,600,000 cash, subject to \$22,300,000 of production payments. At December 31, 1967 these production payments had been reduced to \$12,662,450 in principal amount. Until production payments are retired, the entire net revenues from the properties so purchased, but not less than 82% of their gross revenue, will be applied to the principal and interest on the production payments and, in addition, the Company will pay all operating costs and ad valorem taxes incident to the oil and gas production and applicable to the production payments. These expenses are material and at December 31, 1967, they were estimated to require in the aggregate the proceeds from the sale of 830,000 barrels of oil and 3,919,000 Mcf of natural gas. Assuming current production rates of 3390 barrels of oil, condensate and plant products per day and 23,400 Mcf of gas per day (with allowances for normal decline due to depletion of reserves) and current prices for oil and gas, it is estimated that the amount applied toward the production payments will be approximately \$3,145,000 in 1968, decreasing annually to \$520,000 in 1973, and amounts not exceeding \$57,000 a year thereafter until 1975. As a result, no cash of consequence will accrue to the Company from these properties prior to 1973 and retirement of the major portion of the production payments. The production payments include provisions for amounts equivalent to interest ranging from 5⅛% to 6¾% on the principal amount remaining unpaid from time to time. In addition, the Company acquired certain royalty interests and working interests in 72,979 gross or 25,218 net acres of undeveloped oil and gas properties in the Mid-Continent area of the United States.

Initially, the properties acquired from Producing Properties, Inc. were supervised by James A. Lewis Engineering, Inc.; however, on August 31, 1966, the Company established its own Mid-Continent Division, headquartered in Dallas, Texas, under the direction of Paul D. Meadows, Vice President. The Company still contracts with Lewis for certain services based on monthly time charges under an agreement subject to cancellation on four months' notice.

In April, 1964, the Company acquired substantially all of the assets, subject to the liabilities, of Fremont Valley Lands, Inc. In addition to purchase money promissory notes (see "Other Commercial Prop-

erties")), such assets consisted of certain oil and gas producing leases in the State of Texas. During 1967, the average daily production net to the Company's interest from these leases consisted of 80 barrels of oil and 390 Mcf of gas.

Exploration Program

Late in 1966 arrangements were completed to conduct an extensive exploration program, primarily directed toward the discovery of oil and gas, in conjunction with Michel T. Halbouty, a consulting geologist, and an independent oil and gas producer with offices in Houston, Texas. The initial budget of the program was \$4,000,000 and a single unaffiliated participant has agreed to provide funds in this amount. The program contemplates exploration within the continental United States, exclusive of Alaska and tidelands and offshore lands, and is proceeding under the direction of the Company and Mr. Halbouty. In return for its administrative and managerial participation, the Company has an interest in the program equal to 15% of the net profits derived from the operation and development of the program properties as a whole. No funds will be expended by the Company except for minor administrative costs.

The initial \$4,000,000 budget under the exploration agreement is expected to fund the program through 1968, but the program may be extended beyond that date if the parties elect to do so. In addition to the \$4,000,000 originally budgeted, the participant has committed the sum of \$640,000 to the program. As of December 31, 1967, 16 prospects have been designated, and of these 15 prospects have been drilled, resulting in 13 nonproductive tests and two new field discoveries.

In October, 1967, the first significant discovery under the program was made when the Pan American Petroleum Corporation/Halbouty/Reserve "Vincent Heirs, Inc. et al." well #1, located in Cameron Parish, Louisiana, in which the program owns a one-third working interest (5% net to the Company after the recovery of all expenses of the program), encountered several gas productive sands. This well is classed as a new field discovery, and named "The East Holly Beach Field."

In January, 1968, the second significant discovery under the Program was made when Alcee Rivette Estate Well No. 1 located south of the Opelousas Field, St. Landry Parish, Louisiana, in which the Program owns a 75% working interest (11¼% net to the Company after the recovery of all expenses of the Program) encountered productive gas and distillate sands. This field is classed as a new field Discovery and is named the "South Opelousas Field."

Canadian Operations

In October, 1966, the Company, in participation with four other companies, obtained in competitive bidding a Crown Drilling Reservation covering 7,680 acres in the Bistcho Ridge area of northwest Alberta, Canada, at an initial cost to the Company of \$471,814 for an 11½% interest.

In December, 1967, two wells were commenced on the Reservation and in January, 1968, one of these wells was abandoned as a dry hole. The joint owners have the right to select eleven quarter sections (an aggregate of 1760 acres) of the Reservation as Crown Leases, or certain other options with respect to further exploration of the Reservation. As a result of this drilling, the Company believes that some additional gas reserves may have been developed. However, under the Regulations made pursuant to the Alberta Oil and Gas Conservation Act, the Company is entitled to hold confidential all data pertaining to these wells at this time and for some period hereafter. Because there is substantial unleased Crown land adjacent to these holdings, it is obviously in the best interests of the Company to hold information pertaining to the results of this drilling confidential until either this information is required to be released by law or there are no more additional Crown petroleum and natural gas rights available in the immediate vicinity.

In November, 1967, the Company (acting on its own behalf and for Michel T. Halbouty) modified an agreement, entered into in April 1967, to the end that the Company and two other oil companies will conduct an extensive exploration program in Western Canada, primarily directed to the discovery of

oil or gas. The initial budget of the program is \$3,000,000 and the Company and Halbouty are obligated for one-third thereof and are entitled to one-third of the benefits of the program. In addition, they are committed to pay one of the companies \$60,000 per year for exploration and administrative overhead. The program expires December 31, 1969, or upon early expenditure of the budgeted funds.

In November, 1967, the Company and Halbouty reached an understanding with an unaffiliated corporate participant pursuant to which the participant assumed 80% of their interest in the program. Except for exploratory wells, benefits of the program accruing to the Company and Halbouty will be shared 44% by the Company and Halbouty (each being entitled to one-half) and 56% by the participant. With respect to exploratory wells, the interests of the Company and Halbouty under the program are shared 20% by them (each one-half) and 80% by the participant until such time as the entire costs to the Company, Halbouty and the participant of drilling all exploratory wells have been recovered from the production resulting from such exploratory wells.

The program may be subject to curtailment or modification under the Direct Foreign Investment program of the United States pursuant to Executive Order No. 11387.

See "Description of Business and Properties of Fargo" herein for a description of Canadian interests held by that company.

Oil and Gas Sales

The Company sells its crude oil and condensate at posted field prices, generally to major companies. During 1967 the average price received for crude oil, condensate and plant products was \$2.73 per barrel, after production taxes and transportation charges. Gas produced by the Company is usually sold to purchasers directly from the wellheads pursuant to long-term contracts. During 1967, the average price received from the sale of natural gas was 15.3 cents per Mcf.

The following tabulation shows the quantities of oil and gas sold by the Company in the five-year period from 1963 through 1967, net to its interests, from producing wells in which it owned an interest, and the amount thereof dedicated to retained production payments:

Year	Crude Oil, Condensate and Plant Products (Bbls)		Natural Gas (Mcf)	
	Net Total Sales	Amount Thereof Dedicated to Retained Production Payments	Net Total Sales	Amount Thereof Dedicated to Retained Production Payments
1963	805,850	282,300	4,146,461	1,861,300
1964	1,495,993	851,100	9,468,442	6,331,600
1965	1,395,473	819,800	9,587,854	6,723,000
1966	1,480,095	869,200	11,430,773	8,052,400
1967	1,643,983	930,750	10,447,831	7,282,160

The above tabulation includes sales from the Mid-Continent properties acquired from Producing Properties, Inc., from September 1, 1963, the date of acquisition of such properties, from properties acquired from Fremont Valley Lands, Inc., from January 1, 1964, from properties acquired from Rice Ranch from January 1, 1965, from properties acquired in the Vernalis Gas Field, California, from August 1, 1965 and from properties acquired from Long Beach Dock and Terminal Company from January 1, 1966.

Drilling Operations

The following table shows the results of the Company's exploratory and development drilling program during the five year period from 1963 through 1967. Gross wells are those in which the Company

participated and net wells are the Company's interest in such gross wells. The table does not include results of the Halbouty-Reserve Exploration Program described at "Exploration Program."

Year	Exploratory Wells Completed (or Abandoned) as						Development Wells Completed (or Abandoned) as					
	Oil Wells		Gas Wells		Dry Holes		Oil Wells		Gas Wells		Dry Holes	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net
1963	1	.25	0	0	5	2.53	7	2.04	0	0	3	1.16
1964	0	0	1	.30	2	.18	12	4.15	2	.42	4	.56
1965	0	0	3	.35	5	1.46	14	5.59	1	.01	5	1.48
1966	0	0	0	0	8	2.95	11	4.14	9	2.01	1	.50
1967	0	0	1	.25	1	.17	9	2.56	3	.36	4	.84

Oil and Gas Properties

In the aggregate, as of December 31, 1967, the Company owned undivided working interests in 282 oil and gas leases on which were located 2404 producing wells, or 338.04 net oil wells, and 262 producing gas wells, or 44.52 net gas wells. The following tabulation shows as of December 31, 1967 the gross and net working interest wells of the Company by states and provinces.

State	No. of Producing Working Interest Leases	No. of Producing Wells, Working Interest—Oil		No. of Producing Wells, Working Interest—Gas	
		Gross	Net	Gross	Net
Texas	123	488	117.07	189	23.83
California	49	1,055	106.81	30	8.06
Nebraska	13	38	17.71	—	—
Illinois	19	517	23.54	—	—
Louisiana	6	9	6.75	—	—
Oklahoma	28	140	22.19	12	3.10
New Mexico	35	116	40.47	26	9.04
Wyoming	4	41	3.50	—	—
Kansas	5	—	—	5	.49

In the aggregate as of December 31, 1967, the Company owned working interests in 56,829 gross acres, or 20,124 net acres of unproved oil and gas leases, as follows:

	Acres	
	Gross	Net
Texas	7,785	4,125
California	120	80
Nebraska	480	400
Illinois	51	13
Oklahoma	440	190
New Mexico	12,555	1,569
Wyoming	560	240
Kansas	27,158	12,654
Alberta, Canada	7,680	853

Oil and Gas Reserves

The following letter of James A. Lewis Engineering, Inc., Petroleum Reservoir Analysts, Dallas, Texas, presents an analysis of the future recoverable hydrocarbons from the properties of the Company:

JAMES A. LEWIS ENGINEERING, INC.

Petroleum Reservoir Analysts

1700 FIDELITY UNION TOWER

DALLAS, TEXAS 75201

February 21, 1968

RESERVE OIL AND GAS COMPANY

550 South Flower Street

Los Angeles, California 90017

Gentlemen:

Pursuant to your request, we have made an investigation of the crude oil, condensate, natural gas liquids and natural gas reserves of Reserve Oil and Gas Company, hereinafter referred to as the "Company."

We estimate that as of January 1, 1968 the net proved crude oil, condensate and natural gas liquids reserves of the Company were 14,644,265 barrels, of which 14,516,873 barrels were considered developed and 127,392 barrels were undeveloped. The net proved natural gas reserves were 87,481,019 Mcf, of which 80,314,299 Mcf were developed and 7,166,720 Mcf were undeveloped.

The distribution of these reserves between the two Company divisions and between the reserve categories of Proved Developed and Proved Undeveloped is as follows:

	Crude Oil, Condensate and Natural Gas Liquids, Barrels	Natural Gas, Mcf
<i>Proved Developed</i>		
Western Division	2,854,144	10,485,482
Mid-Continent Division	11,662,729	69,828,817
Total Proved Developed	14,516,873	80,314,299
<i>Proved Undeveloped</i>		
Western Division	24,000	984,375
Mid-Continent Division	103,392	6,182,345
Total Proved Undeveloped	127,392	7,166,720
Grand Total—Proved Reserves	14,644,265	87,481,019

An anticipated additional capital expenditure of \$84,175 will be required to permit recovery of the total proved undeveloped reserves shown above.

The net reserves to the Company set forth above are before deduction of future oil and gas production required to satisfy certain existing production payments. The aggregate principal balance of production payments outstanding at January 1, 1968 amounted to \$12,866,412. From the Company's net proved reserves, approximately 3,636,433 barrels of oil and 17,815,647 Mcf of gas will be required to satisfy the aggregate principal production payment balances and 527,454 barrels of oil and 2,510,291 Mcf of gas will be required to pay the interest thereon. In addition, the proceeds from the sale of approximately 829,557 barrels of oil and 4,047,559 Mcf of gas will be required to pay the production expenses and ad valorem taxes incident to the production of the oil and gas necessary to satisfy the production payments. In the aggregate it will require the proceeds from the sale of approximately 4,993,444 barrels of oil and 24,373,497 Mcf of gas to retire the production payments and pay operating expenses and ad valorem taxes incident thereto and thereafter there will remain proved reserves of approximately 9,650,821 barrels of oil and 63,107,522 Mcf of gas accruing to Reserve free of the production payments.

Approximately 7,452,000 barrels of the estimated net proved reserves are located in fields where, because of restriction of production, the average current annual production rate is only approximately 5.5 percent of the estimated reserves which, of course, affects the present worth thereof since income therefrom will be deferred over a greater period of time.

The Company owns interests in certain fields which, in our opinion, have potential crude oil reserves over and above the proved reserves previously stated herein and which may be recoverable by water flood operations or other secondary or pressure maintenance operations in the future. The ultimate primary recovery to the Company's interests in these fields has been estimated at 9.2 million barrels. If and when the water flood programs which have been planned or initiated prove successful, as is indicated by engineering studies, it would not be unusual to recover additional crude oil reserves approaching 65 percent of the amount produced by primary methods.

We have investigated the reserves of the Company at approximate annual intervals since 1963, and have investigated the reserves attributed to those properties acquired from Producing Properties, Inc. at approximate annual intervals since 1961. We have been afforded complete cooperation by officers and employees of the Company and have been given access to such accounts, records and geological and engineering reports as were desired.

Respectfully submitted,

JAMES A. LEWIS ENGINEERING, Inc.

GEORGE S. MONKHOUSE, P.E.

President

Regulation

The oil and gas industry is subject to both state and federal legislation and administrative regulation which, to a considerable extent, affect its activities. The operations and earnings of the Company may be affected from time to time to an unpredictable extent by the limitations imposed by laws and regulations now or hereafter in effect in the states and provinces in which its business is carried on, including those providing for conservation, proration, curtailment, or other forms of limiting or controlling production. The maximum allowable production of oil and gas from wells in some of the states in which the Company operates is limited to amounts which are fixed at periodic intervals by regulatory authorities in such states. In Canada the oil and gas industry is subject to comprehensive regulation. Approximately 73% of the Company's oil reserves and 86% of its gas reserves and associated natural gas liquids reserves are subject to production proration. Approximately 75% of the Company's natural gas reserves are subject to regulation by the Federal Power Commission.

Commercial and Residential Real Property and Other Activities

In April 1966, the Company acquired the assets, subject to liabilities, of Apple Valley Building and Development Company in exchange for 2,500,326 shares of the Company's Common Stock, and 63,750 shares of 5¼% Series B Preferred Stock. The Company has since operated the property so acquired within its Apple Valley Ranchos Division.

Apple Valley Ranchos Division offices are located in Apple Valley, California, an unincorporated desert community of approximately 12,000 people, located in the upper Mojave Desert (3,000 ft. elevation), about 90 miles east of Los Angeles and adjacent to the city of Victorville. The Company, as did its predecessor, has to date limited development activities to subdividing, improving and selling land owned by it and by others (as exclusive sales agent), to general real estate brokerage, and to construction and operation, either directly or through lease arrangements, of commercial properties. The Company has not engaged in the business of constructing homes for sale.

As of December 31, 1967, the Company held fee title to an aggregate of 9,776 acres in the Apple Valley area, most of which are in noncontiguous blocks. The only encumbrances on this land are five purchase-money deeds of trust on 177 acres of undeveloped land securing indebtedness with a principal balance of \$79,526 on December 31, 1967.

The mode of development of the Apple Valley property has been to subdivide a specified area (usually 100-160 acres); grade the area; install basic roads and water main improvements; and offer the subdivision for sale to the public. Although the figure varies, a 160-acre subdivision generally contains 270 to 285 residential lots. Until the Company decides to subdivide an area, it invests no money either in debt service (except for the small indebtedness described above) or in otherwise preparing that property for sale. Land is typically sold under a conditional contract of sale with a down payment of approximately 20% or less, balance payable at 1% per month, including interest at 6% per annum. Gross prices for lots sold at Apple Valley vary, depending upon location, size, and aesthetic values. The range of lot prices in subdivided areas has been from \$3,000 to \$19,500 per lot. For financial reporting purposes, sales of Company-owned lands are included in income at the full sales price, less costs and a provision for losses on future repossession, in the year in which the contract of sale is executed (see Note 3 to Financial Statements of the Company). The Company has entered into a trust agreement with a trust company, as trustee, pursuant to which all unsold subdivided land owned by it is held and all unpaid contract balances are collected by the trustee for the benefit of the Company.

As of March 1, 1968, 45 lots owned in fee by the Company were available for purchase in subdivided areas at Apple Valley. Of the remainder of the 9,776 acres held in fee, approximately 8,000 acres are considered suitable for residential subdivision. The remainder of the acreage is, or is planned to be, devoted to commercial uses and community supportive activities.

The Company (continuing the practices of its predecessor started in 1951) also acts as exclusive sales agent for property owned by others under trust agreements pursuant to which a trust company holds title to the property until the buyer completes payment in full under a conditional contract of sale. The trust agreements typically provide that the Company receive 50-70% of the sales proceeds and interest. Since this land is generally sold pursuant to conditional contracts of sale, the Company receives its share of payments only when and if they are made by the buyers of the lots. At December 31, 1967, net commissions receivable on these properties amounted to \$4,975,534. For financial reporting purposes, these commissions are recognized as income when received (see Note 4 to Financial Statements of the Company). Against this income, the Company will have liabilities of approximately \$160,756 for salesmen's commissions and \$2,231,311 for deferred federal and state income taxes. At December 31, 1967, there were 151 lots available for purchase in subdivisions of lands owned by others, and 252 acres of land owned by others had been committed under trust agreements with the Company for future subdivision.

Directors and officers of the Company have participated individually in four trust subdivisions and have sold land personally owned by them on the same terms offered by the Company to other land owners. Since 1951, Newton T. Bass has so committed 153.55 acres; B. J. Westlund has so committed 164.90 acres; and Joseph A. Ball has so committed 133.51 acres. Children of Messrs. Bass, Westlund and Ball committed an aggregate of 314.07 acres of land to such trusts during this period. At December 31, 1967, Newton T. Bass and Walter E. Cramer, Jr. retained individual ownership uncommitted to any trust agreement of 203 acres and 88.33 acres of land, respectively, in the Apple Valley area. (See "Management" for further information concerning these individuals.)

The Apple Valley Ranchos Division currently maintains branch sales offices at Long Beach, Anaheim, Rosemead, and North Hollywood, in addition to the Apple Valley headquarters. Approximately 72 full-time, and 146 part-time, sales personnel work out of these offices. Salesmen are independent agents and are compensated on a commission basis only. Supervisory sales personnel receive a salary and commissions.

During the period 1945 through February 29, 1968, the Company and its predecessors have achieved gross land sales (with their own and others' land taken at full sales price) at Apple Valley aggregating \$75,068,000, representing approximately 14,100 lots, including resales of repossessed lots. Of this number approximately 87% were single family dwelling lots, 11% were multiple dwelling lots, and 2% were commercial use lots. From 1963 to February 29, 1968, gross sales of land owned by the Company and its predecessors and by others in the Apple Valley area were as follows:

<u>Year</u>	<u>Aggregate Amount</u>	<u>No. of Company Owned Lots</u>	<u>No. of Lots Owned by Others Subject to Trust Agreements</u>
1963	\$1,800,000	139	178
1964	2,500,000	235	172
1965	2,900,000	245	207
1966	3,500,000	249	305
1967	3,000,000	166	366
1968 (through February 29)	347,000	16	42

The decline in the gross sales of property during 1967 and early 1968 was attributable to a number of factors. The Company was delayed in preparing subdivisions because of extended negotiations with local authorities over design and drainage considerations. These matters have now been agreed upon, and the Company has recently completed the subdivision of land owned by others containing 80 lots and is offering them for sale. Furthermore, a subdivision of 539 lots of land owned in fee by the Company will become partially (i.e., 142 lots) available for sale in March, 1968. The aggregate decline for the entire year 1967 as compared to 1966 is 14.3%.

As of December 31, 1967 there were 1,315 contracts of sale with an aggregate of principal balances of \$5,092,332 on property originally owned by the Company and its predecessor, and 3,919 contracts of sale with an aggregate of principal balances of \$7,746,440 on property owned by others and sold by the Company. The Company also on that date held a beneficial interest in 27 deeds of trust which secured an aggregate of \$457,124 principal indebtedness to the Company.

During the period commencing January 1, 1963 and ending February 29, 1968 there were 408 repossessions of property sold by the Company and its predecessors from lands held in fee. The following chart sets out the number of repossessions by years:

<u>Year</u>	<u>No. of Repossessions of Company-Owned Lots</u>
1963	70
1964	18*
1965	125*
1966	85
1967	95
1968 (through February 29)	15

*The disparity in the number of repossessions in these years reflects the threat of federal tax liabilities that had been raised with respect to operations of the Company's predecessor. Because part of this proposed tax liability was based upon alleged gains realized by Apple Valley Building and Development Company in repossessing property, during most of the period of this tax liability dispute, repossessions were postponed if possible. This accounts for the increase in repossessions in 1965 when the federal tax liability then under consideration had been largely settled and repossessions which could have been made earlier were effected.

With respect to the land use planning and flood control, the Company is subject to the jurisdiction of San Bernardino County, California. Upon reaching a decision to subdivide a portion of land, the Company files a subdivision map conforming to state and county law. Deed restrictions upon land sold by the Company at Apple Valley impose architectural controls upon the purchaser of this land. Initially, this architectural control is enforced by the Company; however, as a tract is developed with homes, the owners of the property in a tract assume the responsibility for maintaining these controls.

The Company owns a hotel property at Apple Valley occupying 29 acres, with 101 rooms, and a main building of 25,000 square feet. The hotel on this property is operated under a lease agreement

with Frontier Hotels, Inc., a California corporation, in which the Company owns a one-half interest. The Company also owns other miscellaneous commercial and service buildings and facilities, including an airport terminal building and runway in the community of Apple Valley. None of these properties is currently encumbered with debt.

A wholly-owned subsidiary of the Company, Apple Valley Ranchos Water Co., a California corporation, is the major supplier of water to the Apple Valley community. Because of the desert nature of the land at Apple Valley, adequate water resources are exceptionally important to further development. Engineering studies indicate that the future needs of the area can be met adequately from present sources. Rates of the Water Company are controlled by the California Public Utilities Commission.

Other Commercial Properties

As noted above (see "Oil and Gas—*Western United States Operations*"), in March, 1966, the Company acquired the assets of Long Beach Dock and Terminal Company. In addition to the oil interests described above, the Company acquired and continues to operate eight warehouses and other structures located on approximately 25 acres of land in the city of Long Beach, California. In the latter part of 1966, the Company constructed an additional warehouse on the property, bringing the total construction on the site to an aggregate of 265,000 square feet. The Long Beach property is owned in fee by the Company and at January 1, 1968, had a depreciated cost value of \$935,962. There are no debt incumbrances against any of these real properties. Cash operating income, before administrative expenses, from these properties for the year 1967 totaled \$114,143.

As noted above (see "Oil and Gas—*Mid-Continent Operations*"), in April 1964 the Company acquired the assets, subject to the liabilities, of Fremont Valley Lands, Inc., a California corporation. In connection with this transaction, the Company assumed payment of Fremont's Cumulative 5½% Debentures in the aggregate principal amount of \$190,300, which at December 31, 1967, were outstanding in the principal amount of \$139,400. In addition to the oil and gas producing leases in Texas described above, the Company acquired purchase-money promissory notes secured by a subordinated lien upon the property sold and having an aggregate unpaid balance of \$410,170 at December 31, 1967. Such notes principally represent the balance of the sales price for approximately 15,000 acres of land at California City, northeast of Mojave, California, which is now under development by Edwards-Town, Inc. While recourse on these notes is limited to lands sold, the Company considers that the underlying land values are sufficient to cover the indebtedness owed to the Company as well as the senior indebtedness secured by the land.

In 1965 the Company acquired undeveloped land near Santa Maria, California, from Rice Ranch Oil Company (see "Oil and Gas—*Western United States Operations*"). The Management feels that a significant portion of this land has residential development potential; however, there is no present plan to subdivide any of this property.

Fertilizer Production

In June 1965 the Company completed the construction of a plant at Hanford, California, for the production of anhydrous ammonia, a commercial fertilizer, and after an initial period of testing and adjustment, the plant went into production early in October of that year. The cost of the plant, the plant site and related facilities, was approximately \$2,400,000. The plant occupies approximately 80,000 square feet of land and is situated on a 50-acre site.

The rated production capacity of the plant is 60 tons a day, and it has a storage capacity of 5,000 tons. In 1967, the plant produced 18,604 tons of anhydrous ammonia (approximately 85% of its rated capacity), of which an aggregate of 17,045 tons were sold by the Company through its exclusive sales agent, Fennelly-Lauer Chemicals, Inc., of Millbrae, California. To date, the operation of the plant has not shown a net profit.

The Company has commenced construction for expanding these facilities to include the production of ammonium phosphate and ammonium sulphate. The construction will proceed in two steps: First, the Company has agreed to purchase a shut down phosphoric acid plant and granulation plant which it

will move to its fertilizer plant. The estimated cost of this phase is approximately \$400,000, of which \$250,000 will be paid in installments of \$50,000 each over a 27-month period. The second phase of the expansion will entail facilities for the production of ammonium sulphate from gypsum under the Merseburg Process used extensively in foreign countries. This process combines the sulphur content of gypsum with ammonia (which will be produced from the present facilities at the plant) and carbon dioxide to produce ammonium sulphate and calcium carbonate. The estimated cost of the second phase of this construction is approximately \$1,100,000. Upon completion of the expansion program, the Company's fertilizer plant will be capable of producing dry fertilizer for which there is a ready market in the California Central Valley Area and will also eliminate the necessity of storing substantial quantities of liquid ammonia during the offseason times for use of fertilizer in this area. The Company anticipates that the expansion program will be completed in the early fall of 1968.

Competition

All of the businesses in which the Company is engaged are highly competitive. In all of them, the Company must meet competition from larger and more strongly financed companies. With respect to the Apple Valley Ranchos Division, there is no substantial competition in the Apple Valley area itself. However, other Southern California desert developments, some of which are located close to Apple Valley, do compete with Apple Valley for prospective purchasers.

Employees

As of December 31, 1967, the Company had 165 full-time regular employees and 10 part-time employees of whom it employs approximately 93 in its oil and gas operations, 15 in its commercial fertilizer operations and 67 in its commercial and residential real estate operations (exclusive of independent real estate sales agents). The Company has no collective bargaining agreements with any labor organization covering its employees. The Company has never had a work stoppage caused by labor problems and considers that its relations with its employees are excellent.

Vacations, holidays, other usual benefits, and a group life insurance program are provided for employees at no expense to them. Hospital and medical insurance premium payments are also provided at no cost to the employees with the Company providing partial premium payments for dependents of employees. In addition, the Company's employees are eligible to participate in Reserve's Thrift Plan. (See "Thrift Plan.")

MANAGEMENT OF THE COMPANY

Directors and Officers

The directors and officers of the Company are as follows:

<u>Name</u>	<u>Title</u>
Jasper W. Tully ^①	Chairman of the Board Emeritus, Director
*Newton T. Bass	Chairman of the Board, Director
*John R. McMillan	President and Chief Executive Officer, Director
Joseph A. Ball	Director
Llewellyn Bixby, Jr.	Director
Walter E. Cramer, Jr.	Vice-President, Director
*Marco F. Hellman	Director
Clinton LaTourrette	Director
Howard C. Pyle	Director
B. J. Westlund	Director
Harold F. Green	Vice-President, Secretary
Paul D. Meadows	Vice-President
Robert E. Aberley	Treasurer

*Member of Executive Committee

① Mr. Tully is not standing for reelection as a director of the Company at the meeting to be held April 25, 1968.

For more than five years prior to their election as directors of the Company, Mr. Newton T. Bass had been President, director and Chief Executive Officer of Apple Valley Building and Development Company (acquired by the Company in 1966); Mr. B. J. Westlund had been a director and major shareholder of Apple Valley; and Mr. Walter E. Cramer, Jr., had been an officer and director of Apple Valley, devoting his full time to its management; Mr. Joseph A. Ball had been a director of Apple Valley and was and is a partner of Messrs. Ball, Hunt, Hart & Brown, attorneys at law, Long Beach, California; Mr. Llewellyn Bixby, Jr., had been President and a director of Long Beach Dock and Terminal Company (acquired by the Company in 1966) and is President of Bixby Land Company, Long Beach, California; Mr. Howard C. Pyle at the present time is engaged in petroleum investments. Between 1961 and 1967 he was a partner in Lacle Petroleum Company; Mr. Marco F. Hellman has been Senior Partner of J. Barth & Co., Investment Bankers, San Francisco, California, and Mr. Clinton LaTourrette has been a partner of LaTourrette & Co., Financial Consultants, Los Angeles, California. Mr. John R. McMillan, President, Director and Chief Executive Officer of the Company since 1963, was an officer of Humble Oil & Refining Company and of Monterey Gas Transmission Company from 1961 through 1963.

Harold F. Green has been with the Company since August, 1954. He has served as Secretary of the Company since 1956 and as Vice President since 1962.

Paul D. Meadows has been Vice President of the Company in charge of its Mid-Continent Division since August 1, 1966. Prior thereto, Mr. Meadows had been Vice President of James A. Lewis Engineering, Inc., Petroleum Reservoir Analysts, since 1961.

Robert E. Aberley joined the Company in 1950, and has served as Treasurer since 1962.

Newton T. Bass, John R. McMillan, Marco F. Hellman, and Howard C. Pyle are, and since September 7, 1967, have been directors of Fargo, and John R. McMillan is President and Paul D. Meadows is Executive Vice President of Fargo.

Remuneration of Directors and Officers

The direct remuneration paid by the Company during its fiscal year ended December 31, 1967, to each director and officer of the Company whose aggregate direct remuneration from the Company exceeded \$30,000, and to all directors and officers as a group, is shown in the following table:

<u>Name of Individual or Number of Persons in Group</u>	<u>Capacities in Which Remuneration Was Received</u>	<u>1967 Aggregate Direct Remuneration</u>	<u>1967 Deferred Compensation</u>
John R. McMillan	President	\$ 50,967	\$12,000
Newton T. Bass	Chairman of the Board	56,611 ^①	—
Walter E. Cramer, Jr.	Vice President	43,907 ^①	—
All Directors and Officers as a Group (presently 13 persons)		256,285	24,000

① Includes bonus payments made to Messrs. Bass and Cramer based on sales of real property in Apple Valley.

Officers are also eligible to participate in the Company's Thrift Plan (see "Thrift Plan").

The Company executed a contract with John R. McMillan on October 16, 1963, under which he was employed for a term of five years as President of the Company. The contract provided for a salary of \$36,000 per year, payable in equal monthly installments, and additional deferred compensation of \$12,000 per year for each year of the term of the contract. Either the Company or Mr. McMillan may terminate the contract at any time upon sixty days' notice. The deferred compensation provision described above is further subject to adjustment, depending upon the circumstances under which Mr. McMillan's employment with the Company is terminated. Upon termination of the employment contract by either the Company or Mr. McMillan, no further payment of the yearly salary will be made. This contract was amended effective April 29, 1966, to extend its term to December 31, 1973, to provide for a salary of \$50,000 a year (instead of \$36,000) and to continue the deferred compensation of \$12,000 per year for the term of the contract as extended.

Apple Valley had an employment contract with Mr. Newton T. Bass, providing for a salary of \$40,000 per year for the five-year period beginning December 1, 1964. In event of his death prior to the end of five years, his widow is to receive one-half, or \$20,000 annually for the balance of the contract term. The Company assumed Apple Valley's obligation under this contract.

The Company has entered into an agreement with Jasper W. Tully, presently Chairman of the Board, Emeritus, pursuant to which Mr. Tully agrees to render services as a consultant to the Company, and the Company agrees to pay Mr. Tully \$18,000 a year during the remainder of Mr. Tully's lifetime. Mr. Tully has been an officer and Director of the Company since 1932.

The Company executed a five year contract with Paul D. Meadows as of August 1, 1966, under which Mr. Meadows was employed as Vice President in charge of the Company's Mid-Continent Division. The contract calls for a salary of \$28,000 per year plus additional deferred compensation of \$12,000 per year for each year of the term of the contract.

Thrift Plan

The Company has a Thrift Plan qualified under Internal Revenue Code Section 401 for the benefit of certain of its employees. Officers of the Company are entitled to participate in this plan. Generally, under the plan participants are permitted to contribute from 1% to 5% of regular base pay, and the Company contributes an amount equal to the aggregate of employee contributions. In addition the Company may make additional contributions out of current or accumulated net profits in each year. The Trustee under the plan, a bank, may invest contributions with broad discretion, except that it may not purchase any securities of the Company. Contributions to the plan by the Company during 1967 and since commencement of the plan have been as follows:

	1967 Contribution	Cumulative Contributions Since Commencement of Plan
John R. McMillan	\$ 2,496	\$ 8,360
Newton T. Bass	2,280	3,420
Walter E. Cramer, Jr.	1,608	2,412
Principal Officers and Directors as a Group (Including Messrs. McMillan, Bass and Cramer).....	9,779	23,297
All Other Employees as a Group.....	43,044	113,869

Stock Options

Concurrent with the employment contract with John R. McMillan dated October 16, 1963, under which he was employed as President of the Company and as a condition of such employment the Company granted Mr. McMillan a restricted stock option in the amount of 30,000 shares of the Company's Common Stock exercisable at the price of \$8.625 per share, such price being the market price of the Company's stock on the Pacific Coast Stock Exchange at the time of granting of the option. The option is exercisable at any time prior to October 16, 1968, at which time the option terminates. Shareholders of the Company affirmed this option to Mr. McMillan on April 27, 1964.

On April 27, 1964, the shareholders of the Company adopted a selected employees stock option plan covering qualified stock options under Section 422 of the Internal Revenue Code with respect to 50,000 shares of authorized but unissued Common Stock. The maximum number of shares as to which options under this plan may be granted to any one employee is 10,000 shares. Each option granted under this plan will expire on a date determined by the stock option committee, but in no event on a date after five years from the date on which the option is granted. The options will be granted at a price equal to the highest price on the Pacific Coast Stock Exchange for the Company's Common Stock on the day the option is granted; provided, however, that if no sale of Common Stock is made on the Pacific Coast Stock Exchange on the date of granting, on the next preceding day on which there was a sale.

Options for the entire 50,000 shares have been granted to 12 key employees under the employees stock options as follows:

<u>Date of Grant of Option</u>	<u>Expiration Date of Options</u>	<u>Option Price Per Share</u>	<u>No. of Shares of Common Stock Covered by Options Granted</u>	<u>No. of Shares of Common Stock Called for by Outstanding Options</u>
7-14-64	7-14-69	\$ 6.875	28,000	21,250
8- 1-66	8- 1-71	\$ 5.25	10,000	10,000
1- 4-68	1- 4-73	\$16.00	12,000	12,000

Mr. Cramer, Vice President of the Company was granted an option on January 4, 1968 to purchase 10,000 shares of the Company's Common Stock at the option price of \$16.00 per share. No other person named under "Remuneration of Directors and Officers" has been granted options under the stock option plan. Officers and Directors as a group, including Mr. Cramer have been granted options for an aggregate of 33,000 shares under the stock option plan as follows.

<u>Date of Grant of Options</u>	<u>Option Price Per Share</u>	<u>No. of Shares of Common Stock</u>
7-14-64	\$ 6.875	13,000
8- 1-66	5.25	10,000
1- 4-68	16.00	10,000

The above does not include the restricted stock option for 30,000 shares of Common Stock granted to Mr. McMillan on October 16, 1963 and referred to above.

Officers and Directors as a group (not Mr. Cramer) have exercised options to purchase an aggregate of 6,000 shares of Common Stock at an aggregate option price of \$41,250. At the time of exercise the aggregate high bid price for such stock was \$114,000.

For information regarding the market value of the securities called for by the Company's outstanding stock options, see "Comparative Data"—"Range of Security Prices," and see Note 11 to "Notes to Financial Statements—Reserve."

Interest of Management and Others in Certain Transactions

Clinton LaTourrette, a director, owned substantial stock interests in Fremont Valley Lands, Inc. prior to its acquisition by the Company in 1964. Mr. LaTourrette did not deliberate in the discussions nor did he take part in the vote of the Board of Directors of the Company in respect of the Fremont acquisition.

Llewellyn Bixby, Jr., became a director of the Company in 1966 upon the Company's acquisition of Long Beach Dock and Terminal Company (See "Description of Business and Properties of the Company") in which Mr. Bixby had substantial stock interests and of which Mr. Bixby was President and a director.

Newton T. Bass and B. J. Westlund, directors, and Mrs. Virginia McConkey, became associated with the Company in 1966 after it acquired Apple Valley Building and Development Company in which they had substantial stock interests and of which Messrs. Bass and Westlund were officers and directors. Messrs. Bass and Westlund and Mrs. McConkey have entered into an escrow agreement with the Company with respect to certain of their shares of the Company's Common Stock. The stock holdings of these individuals and terms of the escrow agreement are described at "Principal Holders of Equity Securities".

Joseph A. Ball and Walter E. Cramer, Jr. became associated with the Company in 1966 after it acquired Apple Valley Building and Development Company of which they were shareholders and directors and of which Mr. Cramer was an officer.

Prior to their association with the Company, Messrs. Ball and Westlund had contracted with the Company to sell their interests in Apple Valley Ranchos Water Co. (60% of outstanding stock) to the Company for cash within a 30-day period following consummation of the Apple Valley Building and Development Co. acquisition. Having received 40% of the outstanding stock of the Water Company in the Apple Valley transaction, the Company consummated the contract with Messrs. Ball and Westlund after they had been elected directors of the Company.

Newton T. Bass, B. J. Westlund and Joseph A. Ball have participated individually in the subdivision of their lands in the Apple Valley area. (See "Commercial and Residential Real Property and Other Activities" for information concerning such participation.)

Marco F. Hellman, a director, is Senior Partner of J. Barth & Co., investment bankers, to whom the Company paid commissions aggregating \$20,000 in connection with the acquisitions of certain properties in April, 1964, and November, 1965. J. Barth & Co. was also an underwriter with respect to the Company's Debentures and certain shares of Common Stock and received compensation as such. Mr. Hellman did not take part in the vote of directors which authorized the Company's issuance of the Debentures.

Officers and directors of the Company as a group own 7,300 shares of Common Stock of Fargo amounting to 0.86% of the outstanding voting stock of Fargo.

Principal Holders of Equity Securities

The following table presents information as to the holdings of Common Stock and Series A and Series B Preferred Stock and Debentures of the Company as of January 31, 1968, by each person who owns of record or beneficially more than 10% of the outstanding voting stock of the Company, and beneficially by all directors and officers of the Company as a group.

Name and Address	Type of Ownership	Shares Owned			% of Outstanding Shares			% of Total Voting Stock	Convertible Debentures (Principal Amount)
		Common	Preferred		Common	Preferred			
			Class A	Class B		Class A	Class B		
Newton T. Bass①	Record and								
P. O. Box 1	Beneficial②	450,768	—	11,130	9.76	—	10.57	9.72	
Apple Valley, California	Record②	46,224	—	2,304	1.01	—	2.19	1.02	
B. J. Westlund①	Record and								
668 McVey #30	Beneficial③	858,181	—	16,859	18.58	—	16.02	18.41	
Lake Oswego, Oregon									
Virginia W. McConkey①.....	Record and								
Route 3, Box 372	Beneficial④	457,665	—	11,474	9.91	—	10.90	9.87	
Shelton, Washington	Record⑤	37,236	—	1,856	.81	—	1.76	.82	
Officers and Directors as a Group	Beneficial⑥	1,458,274.5	110	30,647	31.58	.39	29.12	31.39	\$1,000

① Messrs. Newton T. Bass, B. J. Westlund and Mrs. Virginia W. McConkey, former shareholders of Apple Valley Building and Development Company, acquired by the Company in 1966 (see "Commercial and Residential Real Property and Other Activities") received their shares of the Company stock as a result of such acquisition. These individuals entered into a contract in April, 1966, with the Company which provided that they initially deposit 1,000,000 shares of the Company's Common Stock in escrow and that with respect to these shares, the Company has the "right of first refusal" to purchase at market price if any of them desire to sell any of the escrowed shares, other than in sales in an offering registered with the Securities and Exchange Commission or sales exempt from such registration, and they granted to the Company an irrevocable proxy to vote the escrowed shares for the election of directors of the Company, but upon no other corporate matter, for a period of five years or until the shares are released from escrow, whichever first occurs. The contract states that in voting the shares pursuant to said proxy, it is the intention of the parties that the Company vote said shares in favor of the election of the management nominees for directors including four nominees designated by these individuals. This escrow was established with Security First National Bank in Los Angeles, California, with 805,000 shares of Common Stock currently on deposit with that Bank as follows:

Newton T. Bass	135,000 shares
B. J. Westlund	535,000 shares
Virginia W. McConkey	135,000 shares

(Notes continued on following page)

- ② (a) 1,718 shares of Common Stock, 81 shares of Series B Preferred which are held by Frances A. Bass, wife of Mr. Bass;
 - (b) 1,028 shares of Common Stock and 52 shares of Series B Preferred which are held by Frances A. Bass as Custodian for the two minor children of Mr. and Mrs. Bass;
 - (c) 37,236 shares of Common Stock and 1,856 shares of Series B Preferred which are held by Mr. Bass and Virginia W. McConkey, Trustees of the Leann Bass Brauch Trust No. 1; or
 - (d) 8,988 shares of Common Stock and 448 shares of Series B Preferred which are held by Mr. Bass and Norman Rasmussen, Trustees of the Eric Bass Family Trust.
- Mr. Bass disclaims beneficial ownership of these shares.
- ③ The statement of beneficial ownership above, does not include 154,080 shares of Common Stock and 7,680 shares of Series B Preferred Stock owned by Dorothy R. Westlund, wife of Mr. Westlund. Mr. Westlund disclaims beneficial ownership of these shares.
 - ④ Includes 322,665 shares of Common Stock held by Mrs. McConkey as Trustee under Trust Agreement in which she has the beneficial interest.
 - ⑤ Mrs. McConkey disclaims beneficial ownership of these shares which are held as indicated in footnote 2(c) above.
 - ⑥ Officers and directors as a group also owned of record as Trustees, beneficial ownership of which has been disclaimed, 47,659 shares of the Company's Common Stock and 2,304 shares of Series B Preferred Stock, aggregating 1.05% of the outstanding voting shares of the Company. Members of officers' and directors' families owned beneficially 190,166.5 shares of the Company's Common Stock and 7,865 shares of Series B Preferred Stock beneficial ownership of which has been disclaimed by the respective officers and directors, aggregating 4.17% of the voting shares of the Company.

No other persons hold of record or beneficially more than 10% of the outstanding voting shares of the Company.

DESCRIPTION OF BUSINESS AND PROPERTIES OF FARGO

General

Fargo Oils Ltd. is an amalgamated company under the laws of the Province of Alberta, under and by virtue of a certificate of amalgamation dated June 30, 1960, issued by the Registrar of Companies of the Province of Alberta. Its executive offices are located at 550 South Flower Street, Los Angeles, California, and its general offices at 630 Sixth Avenue Southwest, Calgary, Alberta, Canada. For some years prior to September, 1967, 27.1% of the outstanding Common Stock of Fargo was owned by General American Oil Company of Texas. On September 7, 1967, the Company purchased all shares of Fargo owned by General American Oil Company of Texas and is presently the owner of these 2,310,626 shares of Common Stock of Fargo constituting 27.1% of its outstanding stock. The shares were purchased by the Company for \$11,091,004.80 cash (i.e., \$4.80 per share), which purchase price was determined in arms-length negotiations between the Company and General American. Upon consummation of the purchase, four of the seven members of the Board of Directors of Fargo resigned and Messrs. Newton T. Bass, John R. McMillan, Marco F. Hellman and Howard C. Pyle, all Directors of the Company, were elected to fill the vacancies thus created; and at this time, John R. McMillan, President of the Company, was elected President of Fargo, and Paul D. Meadows, Vice President of the Company, was elected Executive Vice President of Fargo.

Oil and Gas

From its incorporation, Fargo has been engaged in the business of exploring for, developing and producing oil and gas in the Western Provinces of Canada (British Columbia, Alberta, Saskatchewan and Manitoba).

Fargo sells its crude oil and condensate at posted field prices generally to major companies. During 1967, the average price received for crude oil, condensate and plant products was \$2.02 per barrel, after production taxes and transportation charges. Gas production by Fargo is usually sold to purchasers directly from the wellheads pursuant to long-term contracts. During 1967, the average price received from the sale of natural gas was 16 cents per mcf. Fargo owns substantial natural gas reserves in British Columbia currently shut-in due to lack of market outlets. A major portion of these gas reserves are attributable to Fargo's interest in the Petitot River Field in extreme northeast British Columbia.

Many of Fargo's producing properties are included in unit operations of the fields in which its properties are located; and in most instances, the units are conducting secondary recovery programs, including water injection. See "Oil and Gas Properties" herein.

Oil and Gas Sales

The following table shows the quantities of oil and gas sold by Fargo in the five year period from 1963 through 1967, net to its interests from producing wells in which it owned an interest and the amount thereof dedicated to production payments:

Year	Crude Oil, Condensate and Plant Products (Bbls)		Natural Gas (Mcf)	
	Net Total Sales	Amount Thereof Dedicated to Production Payments	Net Total Sales	Amount Thereof Dedicated to Production Payments
1963	1,075,613	609,500	1,886,196	150,200
1964	1,169,165	577,100	1,758,945	111,300
1965	1,248,730	539,800	2,789,337	202,000
1966	1,479,785	623,600	2,725,004	196,800
1967	1,563,204	609,300	3,049,742	228,700

Drilling Operations

The following table shows the results of Fargo's exploratory and development drilling during the five year period from 1963 through 1967. Gross wells are those in which Fargo participated and net wells are Fargo's interest in such gross wells:

Year	Exploratory Wells Completed (or Abandoned) as						Development Wells Completed (or Abandoned) as					
	Oil Wells		Gas Wells		Dry Holes		Oil Wells		Gas Wells		Dry Holes	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net	Gross	Net
1963	9	4.00	2	0.38	8	2.68	27	16.90	—	—	3	2.25
1964	2	1.25	1	0.13	3	0.56	67	27.69	—	—	14	6.70
1965	—	—	2	0.36	10	2.00	45	27.64	1	0.25	2	1.50
1966	3	0.83	2	0.43	7	1.08	34	15.90	1	0.50	5	3.63
1967	3	1.72	3	0.82	9	2.54	22	11.93	2	0.54	10	5.97

Oil and Gas Properties

In the aggregate, as of December 31, 1967, Fargo owned interests in 303 gross oil wells or 195.71 net oil wells and 86 gross gas wells or 26.21 net gas wells. During 1967, Fargo's average daily production amounted to 4,282 barrels of oil and condensate and 8,355 Mcf. of gas. The following table shows as of December 31, 1967, the gross and net working interest wells of Fargo by Provinces:

Province	No. of Producing Working Interest Leases	No. of Producing Wells, Working Interest—Oil		No. of Producing Wells, Working Interest—Gas	
		Gross	Net	Gross	Net
British Columbia	29	36	6.28	44	10.32
Alberta	34	53	19.12	29	3.51
Saskatchewan	59	182	157.71	13	12.38
Manitoba	10	32	12.60	—	—

In addition to the above, Fargo has contributed to unitized areas 138 gross oil wells, or 86.31 net oil wells, and 12 gas wells, or 5.25 net gas wells. The following table shows as of December 31, 1967, gross and net working interest wells which Fargo has contributed to units by provinces:

Province	No. of Company Wells Contributed to Units, Working Interest—Oil		No. of Company Wells Contributed to Units, Working Interest—Gas	
	Gross	Net	Gross	Net
Alberta	30	12.01	12	5.25
Saskatchewan	91	63.15	—	—
Manitoba	17	11.15	—	—

At December 31, 1967, Fargo owned working interests in 2,097,805 gross acres or 646,836 net acres of unproved oil and gas properties, as follows:

Province	Acres	
	Gross	Net
British Columbia	985,979	298,265
Alberta	373,849	126,931
Saskatchewan	235,074	90,048
Manitoba	2,817	1,197
Northwest Territories	500,086	130,395

In addition, Fargo owns royalties under properties developed and operated by others. For the year 1967, Fargo received \$87,741 royalty income.

Fargo has followed the practice of financing the development of producing properties by the sale of production payments which are repaid out of the proceeds of production. The principal amount of production payments sold during each year, amounts paid thereon and amounts outstanding at December 31 of each year are set forth in the following table:

	Amount Sold During Year	Principal Payments During Year	Aggregate Amount Outstanding on December 31
1963	\$ 741,000	\$1,128,599	\$1,845,357
1964	2,096,000	1,089,412	2,851,945
1965	2,496,000	1,030,041	4,317,904
1966	1,390,000	1,122,452	4,585,451
1967	2,525,000	1,121,946	5,988,505

All production payments include provisions for amounts equivalent to interest ranging from 6 $\frac{1}{2}$ % to 6-5/6% per annum accruing monthly on the unrecovered balances.

Oil and Gas Reserves

The following letter of James A. Lewis Engineering Co., Ltd., Petroleum Reservoir Analysts, Calgary, Alberta, Canada, presents an analysis of the future recoverable hydrocarbons from the properties of Fargo:

JAMES A. LEWIS ENGINEERING CO. LTD.

Petroleum Reservoir Analysts

736 EIGHTH AVENUE S.W.

CALGARY, ALBERTA

February 21, 1968

FARGO OILS LTD.
630 Sixth Avenue S.W.
Calgary, Alberta

Gentlemen:

In accordance with your request, we have determined the net proved reserves of crude oil, natural gas, natural gas liquids and sulphur owned by Fargo Oils Ltd. (hereinafter referred to as Fargo).

As of January 1, 1968 the net proved crude oil, condensate and natural gas liquids reserves owned by Fargo have been estimated to be 18,926,854 stock tank barrels. On the same date, Fargo's net natural gas reserves were 131,873,052 Mcf. Sulphur recovery expected with production of the above gas reserves has been estimated to be 980,216 long tons. These reserves are net to Fargo after deduction of all royalties and overriding royalties owned by others but before deduction of reserves dedicated to the retirement of the outstanding production payments. Distribution of these reserves by province is as follows:

	<u>Oil, Condensate and NGL's, Barrels</u>	<u>Gas, Mcf</u>	<u>Sulphur, Long Tons</u>
<i>Working Interest</i>			
Alberta	7,872,997	99,128,848	980,180
British Columbia	2,179,926	30,437,204	—
Manitoba	888,445	—	—
Saskatchewan	7,737,546	—	—
Total	18,678,914	129,566,052	980,180
<i>Royalty Interest</i>			
Various Areas	247,940	2,307,000	36
TOTAL	18,926,854	131,873,052	980,216

All of the above reserves are developed producing except 20,398,597 Mcf of shut-in gas reserves located in British Columbia. The liquid hydrocarbon reserves are composed of 16,523,991 barrels of oil and 2,402,863 barrels of condensate and natural gas liquids.

Future capital investments required for adequate expansion of producing facilities for recovery of the above reserves have been estimated to be \$1,260,300.

Currently outstanding production payments amount to \$5,988,505. A production forecast of the dedicated properties indicates that this debt will be retired in less than four years. Interest on the unpaid balance in the interim will total \$477,223 for a total monetary requirement by Fargo of \$6,465,728. It is estimated that approximately 2,620,000 barrels of oil, condensate and natural gas liquids, 6,367,000 Mcf of natural gas and 52,000 long tons of sulphur will be required to satisfy this debt and related production expenses. Remaining net reserves to Fargo, free of encumbrances, are therefore estimated to be 16,306,854 barrels of liquid hydrocarbons, 125,506,052 Mcf of natural gas and 928,216 long tons of sulphur.

Approximately 31 per cent of the oil reserves owned by Fargo (5,146,000 barrels) are located in fields where future producing rates will be held below productive capacity by proration to market demand. Essentially all of the company's sulphur reserves (980,000 long tons) and slightly over half of its natural gas reserves (70,000,000 Mcf) are located in Crossfield, Alberta.

Fargo owns interests in certain fields which, in our opinion, have crude oil reserves over and above those previously stated which should be recoverable by waterflood operations. In most instances such operations have been underway for a short period of time and additional performance verification is required before these reserves can be considered proved. The ultimate primary recovery to the company's interests in these fields has been estimated to be 6.4 million barrels. Where pressure maintenance operations are successful, it is not unusual to recover additional crude oil reserves approaching 75% of the expected recovery by primary methods.

The findings reported herein are based on a comprehensive investigation of the Fargo interest properties, the detailed results of which were submitted to the company on February 16, 1968. During the preparation of these studies, we have had access to the offices and records of the company in Calgary, Alberta and have been afforded complete co-operation by officers and employees of the company.

It was not deemed necessary to conduct field examinations of property conditions and the character of ownership and other factual data furnished by the company have been accepted as represented.

Very truly yours,

JAMES A. LEWIS ENGINEERING CO. LTD.

J. E. MICHAUD, P. ENG.
President

JEM:gs

Gas Plants

The following table shows Fargo's interest in various gas plants, all located in Alberta, Canada:

	Name of Plant			
	Carstairs-Crossfield	Crossfield East	Sylvan Lake	Three Hills Creek
Operator	Home Oil Company Limited	Pan American Petroleum Corporation	Hudson's Bay Oil and Gas Company Limited	Pan American Petroleum Corporation
Type of plant	refrigeration-absorption	refrigeration-sulfinol	absorption-dessicant	absorption-dessicant
Fargo's interest	1.177%	gas— 12.8129905% sulphur— 9.413%*	5.923913%	.6691%
Total Plant Capacity:				
Raw gas mmcf per day.....	305	142	50	10
Residue gas, mmcf per day.....	256	87	43	10
Propane, barrels per day.....	3,700	—	712	—
Butane, barrels per day.....	3,150	—	436	—
Pentanes, barrels per day.....	10,400	1,060	582	134
Sulphur, long tons per day.....	42	1,480	—	—

*See "Sulphur Plant" below.

Sulphur Plant

Fargo is a participant in a plant constructed in 1967 in the Crossfield, East Field, Alberta, Canada, designed to produce 1,480 long tons of sulphur per day from sour gas when fully operative. This plant will extract sulphur from sour gas produced from the Crossfield, East Field D-1 Sour Gas Reservoir. After treatment in the plant, Fargo's share of the unit gas is returned to its credit as sweet gas available for sale.

Fargo initially nominated for a 9.4% interest in the sulphur plant and gas gathering facilities. Its interest would require an estimated aggregate cash payment of \$2,600,000.00 by Fargo, of which

\$1,848,000.00 was paid in 1967. Fargo's actual interest in the plant will be adjusted to correspond to Fargo's interest in the Crossfield, East Field D-1 Sour Gas Reservoir. Studies currently in progress indicate Fargo will own an approximate 8.1% in the unit and plant. Fargo's share of the construction costs will then be adjusted accordingly.

Fargo has contracted to sell its share of the sulphur produced from the plant for a period of three years at prices ranging from \$45 per metric ton in 1968 to \$43 per metric ton in 1970 f.o.b. the plant.

Pipeline Company

British Columbia Oil Transmission Co. Ltd. ("BCOT") was formed to transport oil from the Blueberry Area to Taylor Flats where it connects with Western-Pacific Products Pipeline to the West Coast. The line cost approximately \$3,500,000, which consisted of \$2,710,000 of 6¼% debentures and the balance in equity capital contributed by the participants. At December 31, 1967, there were \$1,350,000 of debentures still outstanding and they will be redeemed by the payment of \$150,000 annually for a period of 9 years commencing 1968. At December 31, 1967, BCOT had a government-approved rate of return of 8½%. It is the intention of BCOT to make application in the spring of 1968 to have this rate increased to 10%. Fargo has a 21.67% interest in BCOT and its share of net income generated by BCOT is currently in the order of \$50,000 per year. This line presently serves the Aitken Creek, Blueberry and Inga Pools with a throughput at the year end of approximately 4,200 barrels per day. With existing facilities, the pipeline is capable of handling 5,000 barrels per day and can be increased to 15,000 barrels per day with additional compressors.

Competition and Regulation

The business in which Fargo is engaged is highly competitive and Fargo must meet competition from larger and more strongly financed companies. The oil and gas industry is subject to comprehensive regulation in each of the Provinces of Canada in which Fargo operates. Approximately 31% of Fargo's oil reserves, but none of its gas reserves and associated natural gas liquid reserves, are subject to production proration by the applicable Provincial authorities.

Employees

At December 31, 1967, Fargo employed 34 full-time regular employees and one part-time employee. Fargo has no collective bargaining agreements with any labor organization covering its employees, and has never had a work stoppage caused by labor problems. Fargo considers its relations with its employees to be excellent.

Vacations, holidays and salary continuation during illness are provided for employees at no expense to them. A group life, hospital and medical insurance program is provided for the employees and their dependents with Fargo and the employees sharing the cost equally.

Fargo has a profit sharing plan qualified under Section 79C of The Canadian Income Tax Act for the benefit of all employees. The employee contributes 2½% and Fargo contributes 7½% of the employee's regular base pay. The increase in the value of the plan is calculated at the end of each year and allocated to each member, and the portion attributable to Fargo's contribution vests with each member, 50% after five years and 5% each year thereafter until a member is fully vested after 15 years participation. The trustees under the plan, two officers and a trust company, may invest the contributions with broad discretion. Contributions to the plan which became effective January 1, 1967, by Fargo since commencing of the plan have been as follows:

Principal officers as a group.....	\$ 2,295
All other employees as a group.....	\$13,883

MANAGEMENT OF FARGO

Directors and Officers

The Directors and officers of Fargo are as follows:

<u>Name</u>	<u>Title</u>
Bert V. Richardson, Q.C.	Chairman of the Board, Director
*John R. McMillan	President, Director
*Newton T. Bass	Director, Chairman of the Executive Committee
*Marco F. Hellman	Director
*Howard C. Pyle	Director
H. Lyle Jestley	Director
Maclean E. Jones	Director
Paul D. Meadows	Executive Vice President
Russell E. Dertell	Vice President and General Manager
David W. Talbot	Vice President and Secretary-Treasurer

*Member of Executive Committee

John R. McMillan has been President, Chief Executive Officer and Director of Reserve since October 16, 1963. Prior thereto and since 1961, he was an officer of Humble Oil & Refining Company and President and Director of Monterey Gas Transmission Company.

Newton T. Bass has been Chairman of the Board and Director of Reserve since April, 1966, when Reserve acquired Apple Valley Building and Development Company. Prior thereto, Mr. Bass was President and a Director of Apple Valley and devoted his full time to the management thereof for in excess of five years.

Marco F. Hellman has been a Director of Reserve since 1964 and is Senior Partner of J. Barth & Co., investment bankers, San Francisco, California.

Howard C. Pyle has been a Director of Reserve since 1962. At the present time Mr. Pyle is engaged in Petroleum Investments. From 1961 to 1967 he was a partner in Lacal Petroleum Company.

Paul D. Meadows has been Vice President of Reserve in charge of its Mid-Continent Division since August 1, 1966, and prior thereto was Vice President of James A. Lewis Engineering, Inc., since 1961.

Bert V. Richardson, Q.C., is Counsel to the firm of Richardson, Taylor, Huband, Wright & Kehler, Barristers and Solicitors, Winnipeg, Manitoba, and has been a Director of Fargo since 1953.

H. Lyle Jestley is the Senior Partner of Jestley, Kirstiuk, White & Jones, Barristers and Solicitors, Vancouver, British Columbia, and has been a Director of Fargo since 1952.

Maclean E. Jones is a partner of Chambers, Saucier, Jones, Peacock, Black, Gain & Stratton, Barristers and Solicitors, Calgary, Alberta, Canada. He was appointed a director of Fargo on March 5, 1968, to fill a vacancy created by the resignation of Mr. Paul W. Matthews.

Remuneration of Directors and Officers

No officer or director received in 1967 aggregate remuneration in excess of \$30,000, and the aggregate remuneration of the 13 persons as a group, who were directors or officers of Fargo, was \$36,000.

Stock Purchase Plan

Fargo employees having six months continuous employment and employed at December 31 of each year are eligible to participate in the Fargo employees stock purchase plan, which has been in effect for

the past ten years. Under this plan, each eligible employee may purchase at the beginning of each year the number of shares of Fargo Common stock determined by dividing 10% of the employee's base pay for the preceding year by the market value at December 31 less the purchase price to be paid by the employee. Such purchase price to the employee is 10% of the market price at December 31 or \$1 per share, whichever is higher. 7407 shares remain available for purchase under the plan.

Fargo does not deduct its contributions toward the purchase of the shares in computing its income tax. All employees are Canadian residents and realize taxable income to the extent of Fargo's contribution toward the purchase of the shares they acquire, with the right to elect to have such income taxed at their average effective tax rate for the preceding three years reduced by 20% of the amount of said contributions to a maximum of \$200.

Principal Shareholders

The following table presents information as to the holdings of Common Stock of Fargo at December 31, 1967, by each person who owns of record or beneficially more than 10% of the outstanding voting stock of Fargo and beneficially by all Directors and officers of Fargo as a group:

<u>Name and Address</u>	<u>Type of Ownership</u>	<u>Common Shares Owned</u>	<u>% of Total Voting Stock</u>
Reserve Oil and Gas Company..... 550 So. Flower St., Los Angeles, Calif.	Record and Beneficial	2,310,626	27.1
Officers and Directors as a group.....	Beneficial	29,581	0.30

Officers and Directors of Reserve own in the aggregate 7300 shares of the Common Stock of Fargo amounting to 0.086% of the total voting stock of Fargo.

The Directors and senior officers of Fargo have a material interest in the Arrangement to the extent that they were on the 1st day of March, 1968 beneficial owners of shares of Fargo as follows:

<u>Directors and Officers</u>	<u>Shares Beneficially Owned, Directly or Indirectly</u>
Bert V. Richardson, L.L.B., Q.C., Chairman of the Board.....	4,000
H. Lyle Jestley, Director	10,000
Maclean E. Jones, Director	10
Newton T. Bass, Director	1,000
John R. McMillan, President and Director	1,000
Marco F. Hellman, Director	2,000
Howard C. Pyle, Director	2,000
David W. Talbot, Vice President	4,685
Russell E. Dertell, Vice President	4,896
<u>Other Senior Employees</u>	
Harold J. Gleusteen	484
William D. Cunningham	184

Certain individuals have been Directors and senior officers of Fargo since January 1, 1967 and are not now Directors or senior officers of Fargo. The present beneficial ownership of shares of Fargo by these individuals is not known to Fargo and is not reasonably within the power of Fargo to ascertain or procure in as much as these individuals are no longer connected with Fargo.

DESCRIPTION OF SECURITIES OF RESERVE

The following is a brief summary of certain of the terms and provisions of the 6½% Convertible Subordinated Debentures due December 15, 1992, the Preferred Stock (including Series A and Series B) par value \$25 per share, and the Common Stock, par value \$1 per share, of Reserve, which will be outstanding after consummation of the exchange offer. The summary does not purport to be complete and is subject in all respects to the terms and provisions of the Indenture referred to below and the Articles of Incorporation of Reserve.

Description of Debentures

Under an indenture dated as of December 15, 1967, between Reserve and Security First National Bank, Los Angeles, California, Trustee, Reserve had outstanding at December 31, 1967, Debentures in the aggregate principal amount of \$14,000,000 bearing interest at 6½% per annum and entitled to an annual sinking fund sufficient to redeem \$700,000 principal amount of Debentures beginning with the year 1978. In addition, Reserve may, at its option, on or before the last business day prior to December 15 of each year beginning with 1975, make an optional sinking fund payment in cash in an amount sufficient to redeem up to, but not exceeding, \$700,000 principal amount of Debentures. The right to make Optional Sinking Fund Payments is noncumulative.

The payment of the principal of (and premium, if any) and interest on the Debentures are subordinated in right of payment to the prior payment in full of all Superior Indebtedness of Reserve. Superior Indebtedness is defined to include indebtedness of Reserve whether outstanding on the date of the Indenture or thereafter incurred, which is (i) for money borrowed and for the payment of which it is responsible or liable as obligor, guarantor or otherwise, or (ii) evidenced by a note or other written instrument incurred, assumed or guaranteed in connection with the acquisition by the Company or any subsidiary of any properties or assets, other than the Debentures, and indebtedness expressly made not superior in right of payment to the Debentures.

The Indenture provides that Reserve will not pay or declare any dividend on, or make any distribution to the holders of, its Common Stock and that neither the Company nor any subsidiary will purchase, redeem or otherwise acquire for a consideration any share of Reserve's Common Stock or make any payment on account thereof, if, after giving effect to such dividend, distribution, purchase, redemption, acquisition, or payment, and to any other such dividend declared but not yet paid, the aggregate of all such payments subsequent to December 31, 1966, would exceed the sum of (a) the net proceeds received by the Company from the issue or sale of its Common Stock after December 31, 1966, including the issue or sale of shares upon conversion after December 31, 1966, of Debentures or other debt securities of Reserve, and (b) Consolidated Net Income (as defined in the Indenture) since December 31, 1966. This provision, however, does not prevent or restrict (i) acquisition of Common Stock in exchange for, or out of the proceeds of the sale of, Common Stock (and such transactions will not be taken into account in calculations under such provision), (ii) payment of a dividend within 60 days after its declaration if payment was permitted at the date of declaration (but such dividends will be taken into account), (iii) declaration or payment of stock dividends (and they will not be taken into account), (iv) payment of regular fixed dividends on any preferred stock, except any preferred stock issued as a stock dividends or other distribution to stockholders (but such payment will be taken into account), or (v) purchase or redemption of the Series A Preferred Stock or Series B Preferred Stock of Reserve (but such purchase or redemption will be taken into account).

The Debentures are convertible, at the option of the holders, into Common Stock of Reserve at an initial conversion price of \$13.125 per share at any time up to the close of business on December 1, 1992 except that such privilege will terminate at the close of business on the 15th day prior to any redemption date as to Debentures called for redemption or if the date fixed for redemption is an interest payment date, on the record date for such interest payment date. The conversion price is subject to adjustment in certain events, including dividends in Common Stock, subdivisions or combinations of Common Stock, and issues of Common Stock or options to purchase Common Stock or securities convertible into

Common Stock at less than the existing conversion price under certain circumstances and the payment of dividends other than cash.

The Debentures are subject to redemption upon not less than 30 days' notice by mail (a) on December 15 in any year, beginning with December 15, 1978, through operation of the Sinking Fund, and beginning with December 15, 1975, through operation of the Sinking Fund by application of Optional Sinking Fund Payments, as described above, at a Sinking Fund Redemption Price equal to their principal amount, together with accrued interest, and (b) at any time, in whole or in part, at the election of Reserve at a Redemption Price equal to the principal amount, together with a premium commencing in the year 1968 of 6.125% and decreasing annually thereafter to the year 1986 and at 100% of principal amount thereafter, together in each case with accrued interest to the Redemption Date.

Description of Capital Stock of Reserve

Reserve's authorized capital consists of 15,000,000 shares of Common Stock, Par Value \$1, and 400,000 shares of Preferred Stock, Par Value \$25, of which 32,000 shares have been classified as 5½% Cumulative Convertible (Voting) Preferred Stock, Series A, and 108,489 shares have been classified as 5½% Cumulative Convertible (Voting) Preferred Stock, Series B. As to the 259,511 undesignated shares of Preferred Stock, the Board of Directors is authorized to fix or alter the dividend rights, dividend rate, conversion rights, voting rights, rights and terms of redemption (including sinking fund provisions), the redemption price or prices, the liquidation preferences, the designation of and the number of shares constituting any such designated series without further Common Shareholder action. Following is a description of the Common Stock as well as brief summaries of certain provisions respecting the Series A and Series B Preferred Stock.

Dividend Rights

After full cumulative preferred dividends on the Reserve's outstanding Series A and Series B Preferred Stock have been paid or set aside for payment, the holders of the Common Stock shall be entitled to dividends in such amounts as may be declared by the Board of Directors. Payment of dividends on the Common Stock (other than stock dividends), and the repurchase or redemption of shares of Common Stock are restricted by the terms of the Debentures. (See "Description of Debentures" and see Note 7 to "Financial Statements—Reserve".)

The holders of both Series A and Series B Preferred Stock will be entitled to receive, out of the net assets of Reserve legally available for the payment of dividends, as and when declared by the Board of Directors, cumulative cash dividends, at, but not exceeding, an annual dividend rate of \$1.375 per share, payable quarterly on the last days of March, June, September and December of each year, which dividends accrue from the dates on which the respective Series A and Series B Preferred Stock are issued. The Debentures do not contain any restriction on the payment of dividends on the Series A or the Series B Preferred Stock so long as Reserve is not in default with respect to such indebtedness.

Voting Rights

The Common Stock and Series A and Series B Preferred Stock possess ordinary voting rights for the election of directors and in respect to other corporate matters, each share being entitled to one vote. In the election of directors, shareholders have the right to cumulate their votes. In the event that dividends on either, or both, the Series A or Series B Preferred Stock then outstanding shall be in arrears for six or more full quarterly dividend periods (whether consecutive or not) the holders of the Series of Preferred Stock on which such arrears exist, voting separately as a class, shall have the right to elect two less than a majority of the directors. Such voting rights terminate when the default is cured.

As to the Series A and Series B Preferred Stock, without the vote or written consent of holders of two-thirds of the outstanding Series voting as one class, Reserve may not (i) adversely change or alter the designations or preferences, privileges, restrictions and other rights of such Series of Preferred Stock, or (ii) issue any shares of any class or series of stock which have preference or priority as to dividends or assets over such Series of Preferred Stock unless such shares of the new class or series of

stock shall be issued, either alone or with other equity securities of Reserve, for a consideration other than cash or consideration partly other than cash, the total value of which, as determined in good faith by the Board of Directors, shall equal or exceed one and one-half times the aggregate par value or involuntary liquidation preference of the shares of the new class or series of Preferred Stock then to be issued, whichever is higher.

Liquidation Rights

In the event of voluntary liquidation, the holders of the Series A and Series B Preferred Stock are each entitled to receive an amount equal to the redemption price then in effect, and in the event of involuntary liquidation, the holders of the Series A and Series B Preferred Stock are each entitled to receive the par value thereof, prior to any payment on account of the Common Stock. After payment of such liquidation preferences, neither the Series A nor Series B Preferred Stock is entitled to participate in any further distribution, and the holders of Common Stock are entitled to share ratably in all assets remaining after payment of such preferences.

Conversion Rights

The Common Stock has no conversion rights. The Series A and Series B Preferred Stock is convertible at the option of the holders thereof into Common Stock at the conversion price (taking the shares of Series A and Series B Preferred Stock at their par value of \$25 per share and subject to anti-dilution adjustments) of \$9.25 per share of Common Stock, with respect to the Series A Preferred Stock and at \$10 per share of Common Stock with respect to the Series B Preferred Stock.

Redemption Rights

The Common Stock is not redeemable. The Series A and Series B Preferred Stock may be redeemed at the option of Reserve any time after June 1, 1970, and April 30, 1971, respectively, at 106% of par value, decreasing by one percentage point per year thereafter until May 31, 1976, and April 30, 1977, respectively, and thereafter at 100% of par value.

Preemptive and Other Rights

There are no preemptive, subscription or redemption provisions applicable to the Common Stock or preemptive or subscription rights available to the Series A or Series B Preferred Stock.

The Transfer Agents and Registrars of the Common Stock are as follows:

<u>Transfer Agents</u>	<u>Registrars</u>
Crocker-Citizens National Bank 453 South Spring Street Los Angeles, California	Security First National Bank 124 West Fourth Street Los Angeles, California
The Chase Manhattan Bank (National Association) One Chase Manhattan Plaza New York, New York	First National City Bank 55 Wall Street New York, New York

INFORMATION CONCERNING FARGO

The information contained herein regarding Fargo and Fargo's financial statements annexed hereto has been furnished by Fargo and Reserve is relying upon Fargo for the accuracy thereof.

BY ORDER OF THE BOARD OF DIRECTORS

HAROLD F. GREEN, *Secretary*

Dated at Los Angeles, California
March 8, 1968

INDEX TO FINANCIAL STATEMENTS

	Page
RESERVE OIL AND GAS COMPANY:	
Reports of certified public accountants.....	46
Balance sheet at December 31, 1967.....	48
Statement of income for the five years ended December 31, 1967.....	13
Statements of earned surplus and capital surplus for the three years ended December 31, 1967.....	50
Notes to financial statements.....	52
 FARGO OILS LTD.:	
Accountants' report	57
Balance sheet at December 31, 1967.....	58
Statement of income for the five years ended December 31, 1967.....	15
Statements of paid-in surplus and earned surplus for the three years ended December 31, 1967.....	60
Notes to financial statements	61
 PRO FORMA COMBINED STATEMENTS (unaudited):	
Pro forma combined statement of income for the five years ended December 31, 1967.....	16
Pro forma combined condensed balance sheet at December 31, 1967.....	17

REPORTS OF CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors

RESERVE OIL AND GAS COMPANY

We have examined the accompanying balance sheet of Reserve Oil and Gas Company at December 31, 1967, the related statement of income for the five years then ended, and the related statements of earned surplus and capital surplus for the three years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have received the reports of other certified public accountants with respect to their examinations of the financial statements of Apple Valley Building and Development Company for the three years ended September 30, 1965 and of Long Beach Dock and Terminal Company for the three years ended July 31, 1965, all of which are included in Reserve's financial statements named above (as described in note 1 thereto).

In our opinion, based upon our examination and the reports of other certified public accountants referred to above, the statements mentioned above present fairly the financial position of Reserve Oil and Gas Company at December 31, 1967 and the results of its operations for the five years then ended, in conformity with generally accepted accounting principles consistently applied during the period after the restatements (which we approve) explained in note 1.

ARTHUR YOUNG & COMPANY

San Francisco, California
February 28, 1968

The Board of Directors

RESERVE OIL AND GAS COMPANY

We have examined the statements of income and earned surplus of Apple Valley Building and Development Company for the three years ended September 30, 1965. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such financial statements (not shown separately herein) present fairly the results of operations of Apple Valley Building and Development Company for the three years ended September 30, 1965, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

WINDES, McCLAUGHRY & Co.

Long Beach, California
November 18, 1965

The Board of Directors

RESERVE OIL AND GAS COMPANY

We have examined the statements of income and earned surplus of Long Beach Dock and Terminal Company for the three years ended July 31, 1965. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such financial statements (not shown separately herein) present fairly the results of operations of Long Beach Dock and Terminal Company for the three years ended July 31, 1965, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

WINDES, McCLAUGHRY & Co.

Long Beach, California
December 13, 1965

RESERVE OIL AND GAS COMPANY

BALANCE SHEET

December 31, 1967

Assets

CURRENT ASSETS:

Cash—including certificates of deposits, \$2,315,000.....	\$ 4,188,099
Accounts receivable	1,463,447
Installment contracts and notes receivable (note 3).....	1,119,170
Commissions receivable (note 4).....	1,162,800
Inventories, at cost (note 5).....	842,469
Prepaid expenses	764,825
	<u>9,540,810</u>

INVESTMENTS AND LONG-TERM RECEIVABLES:

Installment contracts and notes receivable (note 3).....	4,365,862
Commissions receivable (note 4).....	3,437,734
Investment in Fargo Oils Ltd. and subsidiary company, at cost (note 12)....	11,466,005
Undeveloped land, at cost	928,612
	<u>20,198,213</u>

PROPERTIES (notes 2 and 6):

Oil and gas properties—gross carrying value.....	44,677,186
Less balance of reserved production payments.....	12,852,173
Oil and gas properties—cost.....	31,825,013
Commercial and other properties—cost.....	4,901,451
	<u>36,726,464</u>
Less accumulated depletion and depreciation.....	21,076,319
	<u>15,650,145</u>

DEFERRED CHARGE, unamortized debt expense (note 7).....	523,104
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\$45,912,272

See accompanying notes.

RESERVE OIL AND GAS COMPANY

BALANCE SHEET

December 31, 1967

Liabilities and Shareholders' Equity

CURRENT LIABILITIES:

Notes payable	\$ 85,667
Accounts payable—trade	1,185,657
Accrued liabilities:	
Royalties payable	\$299,323
Mineral rights and other taxes	132,617
Construction costs payable	329,988
Commissions payable	110,000
Other	207,912
	<u>1,079,840</u>
	<u>2,351,164</u>

LONG-TERM LIABILITIES:

6½% convertible subordinated debentures due December 15, 1992 (note 7)	14,000,000
Notes payable and other long-term debt (note 7)	378,472
Commissions payable	156,429
Deferred federal and state income taxes (notes 4 and 8)	4,405,000
	<u>18,939,901</u>

DEFERRED INCOME, less related income taxes (note 4)

2,449,000

COMMITMENTS AND CONTINGENCIES (notes 8 and 13)

—

SHAREHOLDERS' EQUITY (notes 1 and 7):

Capital stock:

Preferred stock, \$25 par value:

Authorized 400,000 shares; issued 28,600 shares Series A and 108,231 shares Series B (including 2,435 treasury shares) (notes 9 and 10)	3,420,775
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Common stock, \$1 par value:

Authorized 15,000,000 shares; issued 4,532,974 shares (including 20,387 treasury shares); reserved for options and conversion of preferred stock and debentures 1,488,472 shares (notes 9, 10 and 11)	4,532,974
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Capital surplus	2,686,749
-----------------------	-----------

Earned surplus	11,617,692
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Treasury stock, at cost: 2,435 Series B preferred shares and 20,387 common shares	(85,983)
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22,172,207

\$45,912,272

See accompanying notes.

RESERVE OIL AND GAS COMPANY

STATEMENT OF EARNED SURPLUS

Three years ended December 31, 1967

	Years Ended December 31,		
	1965	1966	1967
Balance, beginning of year (note 1)	\$6,179,180	\$ 8,167,293	\$ 9,881,570
Net income from statement of income.....	2,207,149	1,803,028	1,923,806
Net income of Apple Valley Building and Development Company for the three months to December 31, 1965 (note 1).....		184,773	
Net income of Long Beach Dock and Terminal Company for the five months to December 31, 1965 (note 1).....		36,734	
	<u>8,386,329</u>	<u>10,191,828</u>	<u>11,805,376</u>
Dividends paid:			
Predecessor merged companies.....	192,575	162,559	
Reserve Oil and Gas Company preferred stock.....	26,461	147,699	187,684
	<u>219,036</u>	<u>310,258</u>	
Balance, end of year.....	<u>\$8,167,293</u>	<u>\$ 9,881,570</u>	<u>\$11,617,692</u>

See accompanying notes.

RESERVE OIL AND GAS COMPANY

STATEMENT OF CAPITAL SURPLUS

Three years ended December 31, 1967

	Years Ended December 31,		
	1965	1966	1967
Balance, beginning of year (note 1)	\$3,135,259	\$3,026,772	\$2,605,124
Expenses incurred in connection with mergers (note 1):			
Rice Ranch Oil Company.....	(108,487)		
Apple Valley Building and Development Company.....		(303,221)	
Long Beach Dock and Terminal Company.....		(118,427)	
Excess of the par value of Series A and B preferred stock over the par value of common stock issued in conversion thereof.....			81,625
Balance, end of year.....	<u>\$3,026,772</u>	<u>\$2,605,124</u>	<u>\$2,686,749</u>

See accompanying notes.

RESERVE OIL AND GAS COMPANY

NOTES TO FINANCIAL STATEMENTS

1. Acquisitions

In April, 1964 the Company acquired the assets, subject to the liabilities, of Fremont Valley Lands, Inc. of Los Angeles, California, in exchange for 172,640 shares of Reserve common stock. The merger has been accounted for in accordance with the pooling-of-interests concept. The accompanying financial statements combine the results of Reserve's and Fremont's operations for the whole of the calendar year 1964, while for the year 1963 the results of Reserve's operations for its year ended December 31 have been combined with Fremont's for its year ended the preceding July 31. The results of Fremont's operations for the five months ended December 31, 1963 have been excluded from the statement of income, but included in earned surplus. The balances shown in Fremont's accounts have been revised retroactively to conform with Reserve's methods of accounting for intangible drilling costs, depreciation, depletion and deferred income taxes.

In May, 1965 the Company acquired the assets, subject to the liabilities, of Rice Ranch Oil Company of Los Angeles, California, in exchange for 215,000 shares of Reserve common stock and 32,000 shares of Reserve Series A, 5½% cumulative convertible preferred stock. The merger has been accounted for in accordance with the pooling-of-interests concept and, accordingly, the results of operations of Rice Ranch are included for all years shown herein.

In March, 1966 the Company acquired the assets, subject to the liabilities, of Long Beach Dock and Terminal Company of Long Beach, California, in exchange for 338,028 shares of Reserve common stock and 44,739 shares of Reserve Series B, 5½% cumulative convertible preferred stock. The merger has been accounted for in accordance with the pooling-of-interests concept. The accompanying financial statements combine the results of Reserve's and Long Beach's operations for the whole of the calendar year 1966, while for the years 1963 through 1965 the results of Reserve's operations for its years ended December 31 have been combined with Long Beach's for its years ended the preceding July 31. The results of Long Beach's operations for the five months ended December 31, 1965 have been excluded from the statement of income but included in the statement of earned surplus in 1966. The balances shown in Long Beach's accounts for 1965 and 1966 have been revised retroactively to conform with Reserve's method of accounting for intangible drilling costs; similar items in prior years were not material.

In April, 1966 the Company acquired the assets, subject to the liabilities, of Apple Valley Building and Development Company of Apple Valley, California, in exchange for 2,500,326 shares of Reserve common stock and 63,750 shares of Reserve Series B, 5½% cumulative convertible preferred stock. The merger has been accounted for in accordance with the pooling-of-interests concept. The accompanying financial statements combine the results of Reserve's and Apple Valley's operations for the whole of the calendar year 1966, while for the years 1963 through 1965 the results of Reserve's operations for its years ended December 31 have been combined with Apple Valley's for its years ended the preceding September 30. The results of Apple Valley's operations for the three months ended December 31, 1965 have been excluded from the statement of income but included in the statement of earned surplus in 1966.

The excess of the aggregate par value of Reserve's preferred and common stock issued in the mergers with Rice Ranch, Long Beach, and Apple Valley, over the aggregate stated values of common stock of the acquired companies (and the excess of the aggregate stated value of the Fremont preferred and common stock over the aggregate par value of the Reserve common stock issued in the merger), has been charged (credited) to combined capital surplus. Expenses of the mergers have also been charged to combined capital surplus.

Reserve's income previously reported for 1966 has been restated to show as an extraordinary item the reduction in federal income tax attributable to the realization of loss carryforwards.

2. Purchases of properties

In September, 1963 the Company acquired substantial oil and gas producing properties in the Mid-Continent area. These properties were acquired subject to production payments existing at the date of purchase and production payments reserved by the seller. In August, 1965 the Company acquired certain gas properties in California which were also subject to existing production payments. All of these production payments include provisions for amounts equivalent to interest ranging from 5½% to 6¾% per annum, accruing monthly on the unrecovered balances. The acquired properties are stated in the Company's property accounts at the cash consideration paid plus the principal amount of the production payments at the date of purchase. The aggregate unpaid balance of the production payments is payable solely out of production from the properties and so is shown as a deduction from the total carrying value of the properties acquired. See note (b) to the Company's statement of income included elsewhere herein for information as to the Company's method of accounting for the proceeds from the sale of production applied to the production payments.

RESERVE OIL AND GAS COMPANY

NOTES TO FINANCIAL STATEMENTS (Continued)

3. Installment contracts and notes receivable

The long-term portion of these receivables is substantially represented by installment land sales contracts which are generally collectible over a 12-year period at the rate of one percent per month including interest; these land sales have been included in income in the year of sale. Title to the property is not conveyed to the purchaser until the contract has been paid in full. Accordingly, the Company has the right to repossess land if the contracts are in default. An allowance for repossessions of \$394,105 at December 31, 1967 has been offset against installment contracts receivable.

4. Commissions receivable and deferred income

The Company has exclusive sales agency contracts with certain landowners in the Apple Valley area. The majority of land sales made under these agreements are on the installment basis, and the Company receives its commissions as the contracts are paid. The Company has no enforceable claim against the purchaser or the original owner of a lot, but has the right to resell repossessed lots. Commission income is accordingly recognized as cash payments are received. An allowance for uncollectible commissions of \$375,000 at December 31, 1967 has been offset against commissions receivable. Because of the contingent nature of the commissions they are offset in the balance sheet by an equivalent amount of deferred income and related income taxes.

5. Inventories

The following is a tabulation of the inventory values used in computing costs and expenses:

	Beginning of Period			December 31,
	1965	1966	1967	1967
Petroleum products, at average cost	\$ 68,482	\$247,485	\$404,559	\$445,713
Subdivided land, at cost.....	343,176	262,520	108,492	163,752
Materials and supplies, at or below average cost.....	216,255	231,012	227,889	233,004
Total, at cost (lower than market value).....	<u>\$627,913</u>	<u>\$741,017</u>	<u>\$740,940</u>	<u>\$842,469</u>

6. Property, plant, and equipment

Intangible drilling costs incurred on productive wells are capitalized, while those incurred in the drilling of dry holes are charged to expense. No amortization is provided while oil properties are in the nonproductive state. Depletion of acquisition costs of productive oil lands and intangible drilling costs are computed on a unit-of-production basis. Depreciation of well and lease equipment is computed on the unit-of-production basis; buildings and other equipment are depreciated on the straight-line and declining-balance methods at rates varying from 2½% to 33⅓% per annum.

The Company provides for depletion and depreciation of oil and gas properties on the unit-of-production method computed by divisions (i.e., Western Division and Mid-Continent Division).

Upon the sale or retirement of complete facilities, the difference between the net book value and the amount realized is charged or credited to income. Where only part of the equipment on producing properties is retired, the cost less the amount realized is charged to the reserve account, except that in certain cases of jointly-owned properties operated by others, the cost of minor items of equipment retired is not reported by the operator and, consequently, the Company merely credits the reported salvage value to the asset account. On retirement or sale of an asset depreciated on the straight-line or declining-balance methods, any gain or loss is included in the statement of income.

The costs of maintenance and repairs necessary to maintain facilities in operating condition, as well as minor renewals, are charged to operating expenses. Betterments and major renewals are capitalized. Inasmuch as the ordinary maintenance work of oil and gas properties is performed by the regular oil field operating personnel, no segregation of these expenses is maintained on the books.

7. Debentures and notes payable

In December, 1967 the Company issued \$14,000,000 of 6½% convertible subordinated debentures due December 15, 1992. Under the terms of the Indenture, the debentures are unsecured obligations of the Company and are convertible into common stock at \$13.125 per share, subject to anti-dilution adjustment. At December 31, 1967 there were reserved

RESERVE OIL AND GAS COMPANY

NOTES TO FINANCIAL STATEMENTS (Continued)

1,066,666 shares of the Company's unissued common stock for issuance upon conversion of the debentures. Beginning in 1978, the Company is required to pay each year into a sinking fund an amount sufficient to redeem \$700,000 principal amount of debentures. The Company may, at its election, redeem the debentures (1) by application of sinking fund payments or (2) at any time, in whole or part at redemption prices ranging from \$106.125 in 1968 to \$100.25 in 1986 and at the face amount thereafter. Sinking fund requirements may be reduced by the principal amount of debentures voluntarily converted into common stock and the amount of debentures redeemed at the election of the Company.

Cash dividends and other cash distributions on the common stock of the Company are limited to the sum of net income earned by the Company after 1966 plus an amount equal to the net proceeds received by the Company from the issue of its common stock after 1966. Debentures in excess of \$2,000,000 were converted into common stock of the Company in the first two months of 1968.

The Company estimates that \$1,344,000 of the issue price of the debentures is applicable to the conversion feature, but does not presently propose to provide for amortization thereof; the annual charge for which is not in any event expected to be material.

The aggregate amounts of maturities of notes payable and other long-term debt for the years 1968 to 1972 are as follows:

Year 1968	\$ 85,667
Year 1969	100,000
Year 1970	77,000
Year 1971	105,000
Year 1972	16,000

8. Federal and State income taxes

The liability for deferred federal and state income taxes represents estimated taxes applicable to installment land sales and commissions receivable on exclusive sales agency contracts.

At December 31, 1967, the Company had an operating loss carryforward of approximately \$1,500,000, which may be utilized as follows: \$1,500,000 through 1968, \$900,000 through 1969, and \$60,000 through 1970. The tax returns for the loss years have not yet been examined by the Internal Revenue Service.

Prior to its acquisition by Reserve, Fremont Valley Lands, Inc. had provided for deferred federal and state income taxes on profits from sales of land reported on the installment basis for tax purposes. In the course of conforming Fremont's methods of accounting with those of Reserve (see note 1) and after appropriate allowances for present estimates of the deferred income tax, the accumulated provision has been reduced by \$734,988. In Reserve's statement of income shown elsewhere herein, this reduction has been included in the provision for federal income tax and allocated among the periods affected.

9. Capital stock

In December 1967, the Company amended its Articles of Incorporation, after shareholder approval, to increase its authorized capital from 200,000 shares to 400,000 shares of preferred stock, \$25 par value, and from 5,000,000 shares to 15,000,000 shares of common stock, \$1 par value.

10. Preferred stock

Each share of the Company's Series A and Series B 5½% cumulative convertible (voting) preferred stock is (a) convertible into 2.703 shares (for Series A) and 2.500 shares (for Series B) (both subject to anti-dilution adjustments) of common stock at the shareholder's option, and (b) callable by the Company, at its option, on or after June 1, 1970 for Series A, and May 1, 1971 for Series B at 106% of par value, decreasing by one percentage point per year until May 31, 1976 for Series A, and April 30, 1977 for Series B, and at 100% of par value thereafter. At December 31, 1967 there were reserved 341,806 shares of the Company's unissued common stock for issuance upon conversion of the preferred stock.

The remaining shares of authorized preferred stock shall have such conversion, dividend and voting rights, and other privileges as the Board of Directors shall designate, if and when such shares are issued.

RESERVE OIL AND GAS COMPANY

NOTES TO FINANCIAL STATEMENTS (Continued)

11. Common stock reserved for options

On April 27, 1964, the shareholders approved adoption of a qualified stock-option plan on 50,000 shares of common stock, and ratified the grant of an option given in 1963 to purchase 30,000 shares of common stock at the market price of \$8.625 per share on the date of grant, for a total of \$258,750. Under the qualified stock-option plan, the Company has granted to certain officers and key employees options to purchase shares of its unissued common stock at the market prices on the dates granted.

Following is information with respect to options granted, exercised, cancelled, expired, outstanding, and exercisable for the years ended December 31, 1965, 1966, and 1967:

	<u>1965</u>	<u>1966</u>	<u>1967</u>
Options granted:			
Number of shares	3,500	10,000	None
Option price per share	\$6.625	\$5.25	
Total option price	\$23,188	\$52,500	
Dates exercisable	April 1966— April 1970	August 1967— August 1971	
Options exercised	None	None	None
Options cancelled:			
Number of shares	None	1,000	3,500
Option price per share		\$6.875	\$6.625
Total option price		\$6,875	\$23,188
Options expired:			
Number of shares	None	None	None
Option price per share			
Total option price			
Options outstanding at end of period:			
Number of shares	62,500	71,500	68,000
Option price per share	\$6.625 to \$8.625	\$5.25 to \$8.625	\$5.25 to \$8.625
Total option price	\$481,313	\$526,938	\$503,750
Options exercisable at end of period:			
Number of shares	59,000	61,500	68,000
Option price per share	\$6.875 to \$8.625	\$6.625 to \$8.625	\$5.25 to \$8.625
Total option price	\$458,125	\$474,438	\$503,750
Market value at date options became exercisable	\$371,250	\$389,250	\$456,875

12. Investment in Fargo Oils Ltd. and Subsidiary Company

Fargo Oils Ltd.

In September, 1967, the Company purchased for \$11,091,005 (at \$4.80 per share) 2,310,626 shares, or 27.1% of the outstanding stock of Fargo Oils Ltd., an oil and gas exploration and development company of Calgary, Alberta, Canada. The purchase was financed by interim borrowing and subsequently refinanced by sale of debentures as described in Note 7.

Fargo Oils Ltd. reported (in Canadian dollars) gross income of \$3,642,576 and net income of \$941,764 for 1967, none of which is reflected in the Company's financial statements.

The closing price of the common stock of Fargo Oils Ltd. on December 29, 1967 for shares traded on the American Stock Exchange was in excess of the Company's per share cost of its 27.1% interest in Fargo.

The Company intends to make available to Fargo shares of its common stock for transfer to the other shareholders of Fargo in exchange for all of their holdings of Fargo's common shares at the rate of .43 shares of Reserve for each share of Fargo. If this transaction is consummated Reserve expects to account for it as a pooling-of-interests.

RESERVE OIL AND GAS COMPANY

NOTES TO FINANCIAL STATEMENTS (Continued)

Apple Valley Ranchos Water Co.

The Company's investment in its wholly-owned subsidiary, Apple Valley Ranchos Water Co., a public utility, is shown in the accompanying balance sheet at cost, which approximates book equity.

13. Commitments

The Company has commenced construction to expand its fertilizer production facilities; the total estimated cost is approximately \$1,500,000.

14. Supplementary profit and loss information

The amounts shown below are included under costs and expenses in the statement of income:

	Years Ended December 31,		
	1965	1966	1967
Maintenance and repairs.....	\$ (a)	\$ (a)	\$ (a)
Depletion, depreciation, and abandonments.....	2,177,307	2,442,258	2,452,585
Taxes, other than income taxes (b).....	666,723	669,000	684,000
Management and service contract fees.....	298,000	244,000	275,000
Rents	49,000	62,000	34,000

- (a) Maintenance and repairs are charged to operating expenses as incurred. All actual betterments are capitalized. Inasmuch as the ordinary maintenance work is performed by the regular oil field operating personnel, no segregation of these expenses is maintained in the accounts.

(b) Taxes:

Mineral rights and property taxes.....	\$ 389,802	\$ 417,000	\$ 415,500
Production taxes	183,000	198,000	216,500
Franchise taxes	93,921	54,000	52,000
	<u>\$ 666,723</u>	<u>\$ 669,000</u>	<u>\$ 684,000</u>

Sales and excise taxes (which are recorded as part of the cost of the materials to which they apply) and payroll taxes (which are included in the total payroll cost charged to the appropriate asset or operating expense account) are not shown in the above summary. There were no royalties, other than oil and gas royalties, paid during the three years ended December 31, 1967.

FINANCIAL STATEMENTS—FARGO OILS LTD.

ACCOUNTANTS' REPORT

The Board of Directors,
FARGO OILS LTD.

We have examined the balance sheet of Fargo Oils Ltd. as of December 31, 1967 and the related statements of income for the five years and statements of paid-in surplus and earned surplus for the three years ended December 31, 1967. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such financial statements present fairly the financial position of Fargo Oils Ltd. at December 31, 1967 and the results of its operations for the five years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

PEAT, MARWICK, MITCHELL & Co.
Chartered Accountants

Calgary, Alberta
February 13, 1968

FARGO OILS LTD.

BALANCE SHEET

December 31, 1967

(Stated in Canadian Dollars)

Assets

Current assets:	
Cash	\$ 455,475
Accounts receivable:	
Trade	614,598
Other	10,566
	<u>625,164</u>
Inventories:	
Crude oil at cost.....	18,526
Oil well supplies, at average cost.....	139,425
	<u>157,951</u>
Prepaid expenses	2,103
Total current assets.....	<u>1,240,693</u>
Investments in other companies—at cost (no quoted market value):	
Notes and debentures.....	67,559
Shares	4,267
	<u>71,826</u>
Advances and deposits—at cost.....	41,033
Oil and gas properties, plant and equipment (Notes 2 and 3):	
Producing oil and gas properties.....	20,361,584
Less allowance for depletion and depreciation.....	5,503,244
	<u>14,858,340</u>
Less unpaid production payments.....	5,988,505
	<u>8,869,835</u>
Undeveloped leases and royalties.....	2,883,576
Dehydrating plant and other equipment, less allowance for depreciation of \$786,128.....	257,911
	<u>12,011,322</u>
	<u>\$13,364,874</u>

See accompanying notes to financial statements.

FARGO OILS LTD.

BALANCE SHEET

December 31, 1967
(Stated in Canadian Dollars)

Liabilities

Current liabilities:

Accounts payable:

Trade	\$ 370,176
Other	898

371,074

Accrued liabilities—interest on notes payable..... 10,193

Notes payable due within one year..... 134,800

Total current liabilities..... 516,067

5% notes payable (Note 6)..... 404,399

Less amount due within one year..... 134,800

269,599

Capital shares (Note 7):

Ordinary common shares of \$1 par value per share.

Authorized 9,000,000; outstanding 8,519,682..... 8,519,682

Paid-in surplus (Notes 1 and 2)..... 500,889

Earned surplus (Notes 1 and 2)..... 3,558,637

12,579,208

Commitments and contingencies (Note 4)

\$13,364,874

See accompanying notes to financial statements.

FARGO OILS LTD.

STATEMENTS OF PAID-IN SURPLUS AND EARNED SURPLUS

Three Years Ended December 31, 1967

(Stated in Canadian Dollars)

	Year Ended December 31		
	1965	1966	1967
PAID-IN SURPLUS (Note 1) :			
Balance at beginning of period.....	\$ 448,977	460,697	475,043
Add excess of market value over option price at date of grant applicable to common stock issued upon the exercise of options (Note 7).....	11,720	14,346	25,846
Balance at end of period.....	<u>\$ 460,697</u>	<u>475,043</u>	<u>500,889</u>
EARNED SURPLUS (Note 1) :			
Balance at beginning of period.....	\$1,095,089	1,795,325	2,616,873
Add net profit for the period.....	700,236	821,548	941,764
Balance at end of period.....	<u>\$1,795,325</u>	<u>2,616,873</u>	<u>3,558,637</u>

See accompanying notes to financial statements.

FARGO OILS LTD.

NOTES TO FINANCIAL STATEMENTS

1. As of December 31, 1962 \$10,751,281 was appropriated, with shareholders' approval, from paid-in surplus to eliminate the company's consolidated deficit at that date. The earned surplus therefore dates from December 31, 1962.
2. Oil and gas properties, plant and equipment are shown in the accompanying balance sheet at cost except as follows. Certain petroleum and natural gas properties and undeveloped acreage located in Canada were revalued, as of January 1, 1962 by reason of the economic conditions affecting the sale of low-gravity crude oil in the Lloydminster area, Canada and due to engineering studies as to valuations in northeastern British Columbia, Canada. The revised values accorded to the properties were determined by independent engineering consultants. This restatement of values resulted in a net charge to deficit of \$8,311,841.

In the case of acquisitions made in exchange for shares of the company's stock, cost has been determined in part on the basis of the fair value of such shares and in part on the fair value of the properties acquired whichever was the most clearly evident in each individual transaction.

Plant and equipment, acquired by the issue of ordinary common shares as stated above, has been recorded, in the case of well equipment, at the vendor's written down value and in the case of other plant and equipment at the original cost to the vendors. The balance of plant and equipment is stated at cash cost.

The unpaid production payments are payable solely out of production. Because these obligations are considered as liens against the properties and there is no direct liability, these amounts are shown as deductions from the property accounts on the balance sheet. These production payments include provision for amounts equivalent to interest ranging from 6½% to 6⅞% per annum, accruing monthly on the unrecovered balances.

It is the company's consistent policy to expense all lease rentals.

3. The company calculates depreciation on the straight line method on all of its depreciable property except automotive and lease and well equipment. Depreciation on automotive equipment is calculated on the diminishing balance method calculated at 30% per annum. Depreciation on lease and well equipment is calculated on the unit of production method based upon estimated recoverable oil reserves. The annual rate used for other depreciable property is 10% of the balance of the asset account at the end of the year.

Depletion of producing petroleum and natural gas leases, which includes leases and well equipment, or interests therein, and amortization of well development costs have been determined on the unit of production method based upon estimated recoverable oil reserves.

Depreciation and depletion have been provided in the accompanying financial statements on costs of producing oil and gas properties without any deduction for related unpaid production payments. Proceeds from the sale of production applied to production payments retained by others are recorded as earnings subject to charges for depletion and depreciation and interest accruing on the production payments. The effect of adopting this method of accounting for production attributable to the production payments rather than an alternative method under which such production, revenues and expenses would not be reflected in the financial statements, has been to increase reported revenue and expenses by the following amounts:

	Years Ended December 31,				
	1963	1964	1965	1966	1967
Oil and gas sales.....	\$1,253,534	1,219,310	1,254,689	1,403,536	1,459,447
Depreciation and depletion.....	331,808	299,588	195,708	230,103	210,926
Interest	124,935	129,898	224,648	281,084	337,501
	456,743	429,486	420,356	511,187	548,427
Increase in net income	\$ 796,791	789,824	834,333	892,349	911,020

Maintenance and repairs are charged to profit and loss as incurred. Renewals and betterments have been capitalized. The company's policy with respect to properties retired or otherwise disposed of, is to credit the asset account with the cost, to relieve the reserve of accumulated depreciation, depletion or amortization relating to such retirements or disposals, and to credit or charge to profit and loss the resulting gain or loss. The accounting for retirements of lease and well equipment is based on the group method of accounting.

4. The company will be required to pay lease rentals on its oil properties, which, based on their holdings at December 31, 1967, will amount to approximately \$220,000 annually.

FARGO OILS LTD.

NOTES TO FINANCIAL STATEMENTS (Continued)

5. Fargo Oils Ltd. has an employees' retirement plan which to December 31, 1965 provided for equal contributions of 5% of payroll by the employees and the company in respect of current services. On January 1, 1966 these contributions were changed to 7½% by the company and 2½% by the employee. At any time prior to the completion of five years service, at which time vesting takes place, the employee is entitled to that percentage of the value of the funds represented by his contributions in relationship to the total contributions made by all employees and the company. After vesting, he is entitled to that percentage of the fund represented by his contributions plus the company contributions on his behalf, in relationship to the total contributions made by the company and by all employees. During 1967 the vesting provisions were changed so that contributions from the effective date of this change will vest as follows: 50% after 5 years and an additional 5% each year thereafter until fully vested. Prior to retirement the employee has the choice of an annuity or cash but upon retirement he must take an annuity. Contributions made by the company for this plan totaled \$7,560 for 1965, \$13,279 for 1966 and \$16,178 for 1967. The value of the fund at December 31, 1967, was approximately \$116,208. It is estimated that the company's contribution for the year 1968 will be \$16,000.

6. The 5% notes payable are unsecured and are repayable by instalments of \$134,800 of the principal amount on the first day of July in each of the years 1968 to 1970. The interest is payable annually on the first day of July.

7. The number of common shares reserved for issue to employees under the stock purchase plan was 10,233 shares at December 31, 1967. Each year, each eligible employee must decide whether or not to participate. If he does participate, he must elect to do so either on an annual or a deferred basis. The annual basis requires the payment of the option price to the company in cash within ten days after the date that notification is received by the employee that he may exercise his option. If the option is taken on the deferred basis, it may be exercised at any time, except for certain restrictions which are effective in the event of termination of the plan or the employment of the optionee.

The purchase price of each share shall be the greater of \$1 or 10% of the market price determined by the last transaction at the Toronto Stock Exchange on the last day of business of the previous year.

An employee is entitled to purchase that number of shares, determined by dividing the market price of the share less the amount payable by the employee into 10% of the employee's base pay for that year.

Information as to options granted and exercised during the period is as follows:

Year ended December 31,	Number of Shares	Option Price		Market Value	
		Per Share	Total	Per Share	Total
1965:					
Options granted	7,904	\$ 1	\$ 7,904	\$2.65-2.99	\$20,977
Options exercised	7,103	1	7,103	2.88	20,457
1966:					
Options granted	8,799	1	8,799	2.80	24,637
Options exercised	7,970	1	7,970	2.97	23,671
1967:					
Options granted	10,325	1	10,325	2.80	28,910
Options exercised	14,359	1	14,359	3.30	47,385
Shares under option at:					
December 31, 1967.....	None				

The option plan which is renewable from year to year at the option of the company was renewed for the year 1968. The options are exercisable at any time while the plan is in effect.

When options are exercised the excess of the market value over the option price at date of grant is charged through the employees' benefit account to profit and loss.

The shares which may be allotted to employees covering their earnings for the year ended December 31, 1967 are 2,826 shares.

8. No provision has been made for taxes on income since the company has expended more than sufficient amounts on drilling and exploration costs which may, for income tax purposes, be applied against the reported earnings so that there are no income taxes payable.

FARGO OILS LTD.

NOTES TO FINANCIAL STATEMENTS (Continued)

9. Supplementary profit and loss information:

<u>Item</u>	<u>Charged Directly to Profit and Loss</u>
Year ended December 31, 1965:	
Maintenance and repairs.....	\$ 189,009
Depreciation, depletion and amortization of fixed assets.....	634,139
Taxes, other than income and excess profits taxes.....	59,880
Lease rentals	204,208
Office and other rents.....	20,733
	<u>\$1,107,969</u>
Year ended December 31, 1966:	
Maintenance and repairs.....	\$ 247,982
Depreciation, depletion and amortization of fixed assets.....	770,588
Taxes, other than income and excess profits taxes.....	64,788
Lease rentals	248,060
Office and other rents.....	35,388
	<u>\$1,366,806</u>
Year ended December 31, 1967:	
Maintenance and repairs.....	\$ 245,160
Depreciation, depletion and amortization of fixed assets.....	757,275
Taxes, other than income and excess profits taxes.....	82,149
Lease rentals	243,988
Office and other rents.....	36,086
	<u>\$1,364,658</u>

AGREEMENT AND PLAN OF COMPROMISE AND REORGANIZATION

MEMORANDUM OF AGREEMENT AND PLAN OF COMPROMISE AND REORGANIZATION (the "Plan") made as of the 1st day of March, 1968, BETWEEN:

RESERVE OIL AND GAS COMPANY, a company incorporated under the General Corporation Law of the State of California, United States of America, with Head Office at 550 South Flower Street, Los Angeles, California (hereinafter called "Reserve"),

OF THE FIRST PART

— and —

FARGO OILS LTD., a company incorporated under the provisions of The Companies Act of the Province of Alberta, with Head Office at the City of Calgary, Province of Alberta (hereinafter called "Fargo"),

OF THE SECOND PART

WHEREAS, Reserve was incorporated on the 16th day of March, 1932, under the General Corporation Law of the State of California, United States of America, and has an authorized capital of 400,000 shares of Preferred Stock, par value \$25 per share, and 15,000,000 shares of Common Stock, par value \$1 per share, of which, on December 31, 1967, 28,600 shares designated 5½% Cumulative Convertible (Voting) Series A Preferred Stock and 105,796 shares designated 5½% Cumulative Convertible (Voting) Series B Preferred Stock and 4,532,974 shares of Common Stock were issued fully paid and nonassessable, and 1,488,473 shares of Common Stock, reserved for issuance upon conversion of the Series A Preferred Stock, Series B Preferred Stock, 6½% Convertible Subordinated Debentures, due December 15, 1992, and upon exercise of outstanding options; and

WHEREAS, Fargo is an amalgamated company under the laws of the Province of Alberta, under and by virtue of a certificate of amalgamation dated June 30, 1960, issued by the Registrar of Companies of the Province of Alberta, and has an authorized capital of 9,000,000 shares of Ordinary Common Stock, par value \$1 per share, of which, on December 31, 1967, 8,519,682 shares were issued as fully paid and nonassessable, and 2,826 shares allotted for issuance upon exercise of outstanding options; and

WHEREAS, Reserve and Fargo have agreed that it would be desirable to amalgamate the two companies by Fargo becoming a wholly-owned subsidiary of Reserve on the terms and subject to the conditions and provisions hereinafter set forth and contained, and that Fargo should enter into a compromise and arrangement with Fargo's members to effect such proposed amalgamation of the two companies; and

WHEREAS, the ultimate objective of the parties hereto, having regard to the need for favorable ruling and opinions regarding taxation implications, both to Fargo and Reserve and its shareholders, is the transfer to Reserve of the whole of the undertaking and property and liabilities of Fargo and the subsequent dissolution of Fargo pursuant to Section 140 of The Companies Act (Alberta) or by winding-up or other appropriate corporate action;

NOW, THEREFORE, THIS AGREEMENT AND PLAN WITNESSETH that in reliance on the representations and warranties of the parties herein contained, and in consideration of the premises and of the covenants and agreements of the parties hereto, IT IS AGREED as follows:

1. The Plan is conditioned:

(a) upon the ratification and confirmation of the Plan by a majority in number representing three-fourths of the shares voted either in person or by proxy at a meeting of the shareholders of Fargo called to consider a compromise and arrangement between Fargo and its members in the form

annexed hereto as Schedule "A" (hereinafter called "the Arrangement") pursuant to Section 139 of The Companies Act (Alberta), and upon the agreement to the Arrangement by the same majority;

(b) upon the sanction (hereinafter called "the sanction") of the Arrangement by the Court as required pursuant to the provisions of Section 139 of The Companies Act (Alberta);

(c) upon the issue of a ruling or opinion of counsel that the additional Reserve shares to be issued as provided herein shall be exempt from the tax imposed under the Interest Equalization Tax Act of the United States;

(d) upon the issue of an authorization, exemption or specific license from the Director, Office of Foreign Direct Investments, Department of Commerce, United States of America, if such shall be required by Executive Order No. 11387 and Regulations issued thereunder;

(e) upon the issue and allotment of the shares of Reserve as provided herein being authorized for listing (on notice of issuance) by each stock exchange upon which the presently outstanding Common shares of Reserve are listed;

(f) upon the approval of the allotment and issue by Reserve of the shares of Reserve required to be allotted and issued pursuant to the provisions of Section 6 hereof by the vote of the shareholders of Reserve (Preferred and Common) having a majority of the voting power of Reserve, in person or by proxy at a meeting of the shareholders of Reserve to be called for the purpose of considering the Plan;

(g) upon the approval, to the extent required, by the competent securities and exchange commissions and similar governmental authorities of all matters and materials in connection with the said meetings of the shareholders of Fargo and the shareholders of Reserve, including, in particular, the proxy statements and information circulars required therefor, it being understood that either company may decline to proceed with such meeting if it would require the untimely disclosure of information regarding its oil and gas properties which is presently confidential and the disclosure of which would, in the opinion of the company affected, not be in the best interests of Reserve and Fargo or either of them;

(h) upon obtaining opinions of counsel that the issuance of the shares of Reserve as provided herein is exempt from registration under the Securities Act of 1933, as amended, of the United States of America, or that a registration statement under the said Act has become effective and that the issuance of such shares is exempt from registration under the security laws of the Provinces of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario and Quebec.

(i) upon the number of shares of Fargo held by shareholders of Fargo who effectively dissent from the Arrangement in the manner and within the period provided in Section 8 of the Arrangement not exceeding 5% of the number of shares of Fargo then outstanding, and upon the amount in cash or other consideration, if any, required by the Court to be given by Fargo to such shareholders of Fargo for their interest in Fargo not exceeding the least of (i) 3% of the fair market value of Fargo's assets, or (ii) the amount of cash and readily realizable assets of Fargo, or (iii) that amount which in Reserve's opinion would, if exceeded, so adversely affect Fargo's operations or financial position as to warrant the termination of the Plan; provided that, by resolution of Reserve's directors, Reserve may in writing waive the provisions of this clause (i) in whole or in part;

(j) upon each of the representations and warranties of Fargo and Reserve contained in Section 2 hereof being true as of the Closing Date with the same effect as if made as of the Closing Date;

(k) upon there having been no substantial adverse changes in the condition, financial or otherwise, of Fargo and Reserve between the date first above written and the Closing Date, except changes occurring in the ordinary course of business; and

(l) upon each of the covenants and agreements of Fargo and Reserve herein contained which are to be observed and performed at or prior to the Closing Date having been duly observed and performed.

2. Reserve and Fargo each respectively represents that its share capital, assets and liabilities are substantially as represented in its balance sheet as at December 31, 1967, and that its properties are substantially as indicated on the said balance sheet or in the report to its members accompanying it.

3. Each of the parties hereto represents and warrants to the other that it has been duly incorporated as respectively represented in the recitals hereto; that it has due corporate power to carry on the business now being carried on by it; that it is duly qualified and in good standing in all jurisdictions where such qualification is required; that it is not a defendant or respondent in any material litigation or administrative proceeding, nor is any threatened, which, if adversely determined against it, would cause any material adverse change in relation to its business or assets.

4. Fargo shall appoint and does hereby appoint Guaranty Trust Company of Canada, Calgary, Alberta, Canada, as trustee for members of Fargo other than those who may effectually dissent from the Arrangement in the manner and within the period provided in Section 8 of the Arrangement, to enable the trust company to transfer to the members of Fargo (except the effectually dissenting members) shares of Reserve in accordance with the terms of the Arrangement.

5. Fargo agrees that, as soon as it is reasonably practicable, it will apply to the Supreme Court of Alberta for an order calling a meeting of its shareholders for the purpose of considering and, if thought advisable, approving the Plan and agreeing to the Arrangement and that, as soon as practicable after the approval of the Plan and agreement to the Arrangement, as aforesaid, has been obtained, it will take the necessary steps to submit the Arrangement to the Supreme Court of Alberta for sanction.

6. Reserve shall, as soon as is reasonably practicable, take the necessary steps (i) to call and hold a special meeting of the shareholders of Reserve for the purpose of considering and, if thought fit, of approving the Plan and the allotment and issue of the shares of Reserve required to be allotted and issued pursuant to Section 7 hereof; (ii) to arrange for the listing on the stock exchanges on which Reserve Common shares are presently listed of all those Reserve shares to be allotted and issued pursuant to Section 7 of the Plan, (iii) to obtain the ruling or opinion required under subsection 1(c) hereof, (iv) to obtain the authorization, exemption or specific license required under subsection 1(d) hereof, or an opinion of counsel that such is not required, and (v) to take all necessary action to comply with subsection 1(h) hereof.

7. Reserve covenants and agrees that upon the Closing Date, Reserve will issue such number of fully paid and nonassessable shares of Reserve Common Stock to Guaranty Trust Company of Canada, as trustee (appointed pursuant to Section 4 hereof), to enable the trust company to transfer to the former shareholders of Fargo (except Reserve and the effectively dissenting shareholders) shares of Reserve in accordance with the terms of the Arrangement.

8. Except for the purposes of carrying out the Plan, and, in the case of Fargo, of carrying out the Arrangement between Fargo and its shareholders, neither Reserve nor Fargo, between the date of this Plan and the Closing Date, shall:

(a) make any distribution by way of dividend or return of capital to its shareholders, except payment of regular dividends on the Preferred Stock of Reserve;

(b) enter into any transaction or agreement or do any act or thing except in the ordinary course of its business, without the consent of the other party hereto;

(c) issue any of its shares, except as may be required (i) upon the exercise of an existing stock option, (ii) upon conversion of Reserve's Convertible Debentures, and (iii) upon conversion of Reserve's Series A Preferred Stock and/or Series B Preferred Stock.

9. This Agreement and Plan shall terminate absolutely and the Arrangement shall be abandoned, unless the parties hereto otherwise agree, if (i) it shall be determined by either party hereto on or prior to the Closing Date that any one or more of the conditions set forth in Section 1 hereof cannot or will not be met by reason of circumstances beyond the control of such party (as to which such party will be sole judge), or that the provisions of Sections 5, 6 and 7 of this Plan cannot or will not be carried out

by reason of such circumstances, and the party making such determination shall have given written notice of such determination to the other party hereto, or (ii) if the Closing Date shall not occur by July 31, 1968. Upon such termination, neither party shall be under any liability to the other hereunder.

10. The Closing Date shall be the date upon which each of the parties hereto shall have given notice to the other party hereto, representing that all of the conditions specified in Section 1 of this Plan have been met. In giving such notice each party hereto shall be entitled to rely on the representations of the other party hereto with respect to those of the said conditions which are to be met by such other party. Each such notice shall be signed by the President or a Vice President together with the Secretary or Assistant Secretary or Treasurer of the party giving the notice. No such notice shall be given on a day when the American Stock Exchange is not open for trading.

11. Reserve agrees that as soon as is reasonably practicable after the Closing Date it will make application to list its Common shares (including the shares to be issued to former Fargo shareholders pursuant to the Arrangement) on the Toronto Stock Exchange and will establish transfer facilities for the transfer of its Common shares in Canada.

12. The directors of Fargo, with the prior consent of Reserve (which shall be deemed duly given and authorized if executed by the President or a Vice President and the Secretary or Assistant Secretary or Treasurer of Reserve under Reserve's corporate seal) shall have power to assent to the provisions made by the Court for any member of Fargo who effectively dissents from the Arrangement within the time and in the manner directed by the Court, and to assent to any modification of this Plan which the members of Fargo or the Court pursuant to the provisions of The Companies Act of the Province of Alberta may think fit to direct or approve.

13. No expenses of Fargo or its members in connection with this Plan or the Arrangement shall be paid by Reserve, but shall be borne and paid by Fargo. Reserve shall bear and pay all expenses of Reserve with respect to this Plan and the Arrangement.

14. Fargo shall, at such time after the Closing Date as the directors of Reserve consider appropriate, having regard to the need for favorable rulings and opinions regarding taxation implications both to Fargo and Reserve and its shareholders, apply to the Court pursuant to Section 140 of The Companies Act (Alberta) for an order providing for the transfer to Reserve of the whole of the undertaking and the property and liabilities of Fargo and the subsequent dissolution, without winding up, of Fargo or alternately shall take steps to dissolve by winding-up or other appropriate corporate action.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first above written.

RESERVE OIL AND GAS COMPANY

By JOHN R. McMILLAN

President

By HAROLD F. GREEN

Secretary

(Corporate Seal)

FARGO OILS LTD.

By B. V. RICHARDSON

Chairman of the Board

By DAVID W. TALBOT

Treasurer

(Corporate Seal)

This is Schedule "A" referred to in an Agreement and Plan of Compromise and Reorganization made as of the 1st day of March, 1968, between RESERVE OIL AND GAS COMPANY, of the First Part, and FARGO OILS LTD., of the Second Part.

IN THE MATTER OF THE COMPANIES ACT OF THE PROVINCE OF ALBERTA

— and —

IN THE MATTER of an Arrangement between Fargo Oils Ltd., a company incorporated under the laws of the Province of Alberta, and the shareholders of Fargo Oils, Ltd.

ARRANGEMENT

1. The Agreement and Plan (hereinafter called "the Plan") between Reserve Oil and Gas Company (hereinafter called "Reserve") and Fargo Oils Ltd. (hereinafter called "Fargo"), dated as of the 1st day of March, 1968, shall be approved, ratified and confirmed.

2. Fargo shall become the wholly-owned subsidiary of Reserve in the manner hereinafter set out.

3. Fargo shall observe and perform all of the covenants and agreements to be observed and performed by it under the terms of the Plan and shall require Reserve to observe and perform all of the covenants and agreements to be observed and performed by Reserve thereunder, including its covenant to issue and allot as full paid and nonassessable to Guaranty Trust Company of Canada, as trustee for the former members of Fargo (other than those former members, hereinafter called "dissentients", who effectually dissent from this Arrangement in the manner and within the period provided in Section 8 hereof) such number of shares of Reserve Common Stock, par value \$1 per share, as shall enable such trust company to transfer to such former members (including holders of options to purchase Fargo shares) shares of Reserve in accordance with the provisions of this Arrangement.

4. Each holder of shares of Fargo shall be entitled to have transferred to him by the trust company 43/100ths fully paid and nonassessable share of Common Stock, par value \$1 per share, of Reserve for each one share of Fargo held by such holder upon surrender by such holder, as hereinafter provided, of the certificate or certificates representing shares of Fargo held by such holder.

Upon the Closing Date defined in the Plan:

(a) All holders of certificates representing shares of Fargo shall cease to be shareholders of Fargo and their names shall be removed from the Register of Shareholders of Fargo;

(b) Reserve (subject to the issue of such director's qualifying shares of Fargo to Reserve's nominees as Reserve may desire) shall become and be the sole shareholder and holder of all the issued and outstanding shares of Fargo, its name shall be entered in the Register of Shareholders of Fargo as such, and it shall be entitled to receive a share certificate or share certificates representing such shares;

(c) Each certificate formerly representing shares of Fargo held by such former shareholder of Fargo shall thenceforth represent:

(i) in the case of a former shareholder of Fargo who is not a dissentient—the right upon the surrender of such certificate to Guaranty Trust Company of Canada, Calgary, Alberta, Canada, on or before July 31, 1968 (or such later date as is provided for in Section 6 hereof) and upon payment of all applicable transfer taxes and transfer fees:

(1) to require Guaranty Trust Company of Canada to transfer to the holder of such certificate the number of whole shares of Reserve Common Stock to which such holder is entitled under the terms of this Arrangement; and

(2) to require Guaranty Trust Company of Canada to account to such holder for any fractional share of Reserve to which such holder would be entitled under the terms of this Arrangement, as more particularly provided for in Section 5 hereof.

(ii) in the case of a former shareholder of Fargo who is a dissident—the right, upon the surrender of such certificate to Guaranty Trust Company of Canada to receive from Fargo such award as may be made to such former member by or as a result of any direction of the Court made in that behalf.

5. Nothing in this Arrangement shall entitle any person to receive a certificate representing a fractional share of Reserve. Should any former shareholder of Fargo become entitled to a fractional share of Reserve, Guaranty Trust Company of Canada shall sell on the American Stock Exchange on the first business day following the Closing Date of the Plan the aggregate of all fractional shares to which Fargo shareholders may be entitled and shall pay to that shareholder in cash or by check an amount representing the net sale price of such fractional share of Reserve.

6. If all certificates formerly representing shares of Fargo held by former shareholders of Fargo who are not dissidents shall not have been surrendered to Guaranty Trust Company of Canada on or before December 31, 1974, in exchange for shares of Reserve, Reserve shall have the right on 60 days' notice to the said trust company and to all such former holders of Fargo's shares, mailed to them postage prepaid at their last respective addresses as shown on the books of Fargo, to decline to permit said trust company to transfer further shares of Reserve pursuant to the Plan or this Arrangement after the expiration of the said period of notice; and upon the expiration of the said period of notice, the right of each former shareholder of Fargo to obtain shares of Reserve or cash in lieu of fractional shares of Reserve or any benefit whatever from Reserve, Fargo or the said trust company with respect to his certificates formerly representing shares of Fargo, shall cease, and the trust company shall transfer to Reserve such remaining shares of Reserve and pay to Reserve the remaining undisbursed proceeds of the sale of fractional interests.

7. If, on or before the last date on which certificates formerly representing shares of Fargo may be surrendered for Reserve shares as aforesaid, the shares of Reserve should be consolidated or divided or otherwise affected by any merger, amalgamation or reorganization, whether similar or dissimilar to that effected between Fargo and Reserve hereby, Reserve shall have the right, upon any such consolidation, division, merger, amalgamation or reorganization, to issue hereunder, in lieu of Reserve Common shares, par value \$1 per share, the new shares of Reserve or securities exchanged for Common shares of Reserve as a result of such consolidation, division, merger, amalgamation or reorganization, on the same basis as if each former shareholder of Fargo, who has not surrendered his certificate formerly representing shares of Fargo, then held the number of Reserve shares to which he would be entitled hereunder upon surrender of such certificate.

8. As soon as possible after the expiration of seven (7) days from the date upon which this Arrangement has been agreed to by the requisite majority of the shareholders of Fargo as provided for by Section 139 of The Companies Act, Fargo shall apply to the Court for an order sanctioning the Arrangement proposed hereby; and if any shareholder of Fargo who did not vote in favor of this Arrangement shall, within the said period of seven (7) days, have expressed his desire to dissent therefrom by a notice in writing addressed to Fargo and sent to or left at its registered office, such notice shall be brought to the attention of the Court on the said application and Fargo shall give notice to such shareholder of any direction made by the Court.

9. After the Closing Date the directors of Fargo shall, with all reasonable dispatch, mail or cause to be mailed to each former shareholder of Fargo who is not a dissident and whose name appears in the register of shareholders of Fargo as at the close of business on the day prior to the Closing Date, at the address of such former shareholder as it appears in said register, a notice of the right of such former shareholder to receive the shares of Reserve to which such former shareholder is entitled hereunder as herein provided.

10. Fargo may, by resolution of its directors, assent to any alteration or modification of this Arrangement or any condition which the Court may think fit to approve or impose and may consent to any alteration or modification of the Plan.

11. Notwithstanding the sanction of this Arrangement by the Court, Fargo may, by resolution of its directors, abrogate this Arrangement in the event that the Plan is terminated, as provided for therein, subsequent to such sanction.

12. References in this Arrangement to "holders of shares of Fargo," "former shareholders of Fargo," and "certificate formerly representing shares of Fargo," shall not (except as used in subsection 4(b) hereof) include Reserve or the certificates for shares of Fargo held by Reserve, as the case may be.

SELECTED EMPLOYEES' STOCK OPTION PLAN—1968

RESERVE OIL AND GAS COMPANY

1. Establishment and Purpose.

There is hereby established a Selected Employees' Stock Option Plan (the "Plan") subject to approval by the holders of a majority of the outstanding shares of voting stock of the Company. The purpose of the Plan is to provide a means whereby key employees of the Company and its affiliates (i.e., officers, directors who are employees, supervisors, and higher compensated employees) may be given an opportunity to purchase shares of the Company under options, which will qualify as "qualified stock options" under Section 422 of the Internal Revenue Code as it is now in effect or as it may hereafter be amended from time to time. The term "affiliates" as used in the Plan means parent or subsidiary corporations, as defined in Section 425 of the Internal Revenue Code, including parents or subsidiaries which become such after adoption of the Plan. The Plan shall become effective immediately following such approval by the shareholders.

2. Amount of Stock.

(a) Options qualifying as "qualified stock options" under Section 422 of the Internal Revenue Code may be granted under this Plan from time to time to key employees of the Company and of its affiliates to purchase an aggregate of not more than 100,000 shares of the Company's Common Stock (\$1 par value). If an option is surrendered or for any other reason ceases to be exercisable in whole or in part, the shares which were subject to such option but as to which the option had not been exercised shall continue to be available under the Plan.

(b) The maximum number of shares for which an option or options may be granted to any employee during any period of five years shall be 15,000.

3. Administration.

(a) The Plan shall be administered by a committee (the "Committee") consisting of not less than 3 directors of the Company to be appointed by the Board of Directors. The Board of Directors may from time to time remove members from, or add members to, the Committee. Vacancies on the Committee, howsoever caused, shall be filled by the Board of Directors. No member of the Committee shall be eligible to receive an option under the Plan. The Committee shall select one of its members as chairman, and shall hold meetings at such times and places as it may determine. A majority of the Committee shall constitute a quorum, and acts of the Committee at which a quorum is present, or acts reduced to or approved in writing by a majority of the members of the Committee, shall be the valid acts of the Committee. Subject to the express terms and conditions of the Plan, the Committee shall have full power to construe and interpret the Plan, to prescribe, amend and rescind rules and regulations relating to it, and to make all other determinations necessary or advisable for its administration.

(b) The Committee may from time to time determine which key employees of the Company or of its affiliates (as described in paragraph 1, above) shall be granted options under this Plan, and the number of shares for which an option or options shall be granted to each of them.

(c) The Committee shall report to the Board of Directors the names of employees granted options, the number of shares covered by each option and the terms and conditions of such option.

4. Terms and Conditions of Options.

Each option shall be evidenced by a written Stock Option Agreement executed by the Company and the person to whom such option is granted and shall be subject to the following terms and conditions:

(a) *Option Price.* The option price shall be the reported highest price of the Company's shares on the American Stock Exchange on the day the option is granted, or if no sale of the Company's stock shall have been made on such Exchange on that day, on the next preceding day on which there was such a

sale. Payment for shares purchased upon exercise of an option shall be in cash or, in the discretion of the Committee, upon an installment basis, with interest of at least 4 percent payable upon any unpaid balance of the purchase price.

(b) *Option Period.* The period for exercising an option shall be the period beginning 12 months from the date on which the option is granted and ending on a date determined by the Committee, but in no event on a date later than 5 years from the time the option is granted, except that (i) if an optionee ceases to be an employee of the Company or an affiliate for any cause other than death during the option period, the option shall be exercisable only prior to the end of the 3-month period following termination of employment or prior to the end of the option period, whichever shall first occur, provided that if termination is for cause the option shall terminate on the date of termination of employment; and (ii) if an optionee dies during the option period, the option shall only be exercisable by the estate of the optionee (or by such person who acquired the right to exercise the option by bequest or inheritance or by reason of the death of the optionee) prior to the end of the 12-month period following death or prior to the end of the option period, whichever shall first occur.

(c) *Adjustments.* If there shall be any change in the shares subject to the Plan, or in any option granted hereunder, through merger, consolidation, reorganization, recapitalization, reincorporation, stock dividend or other change in corporate structure, appropriate adjustments shall be made by the Committee in the aggregate number of shares subject to the Plan, the maximum number of shares for which options may be granted to any one employee and the number of shares and the price per share subject to outstanding options in order to preserve, but not to increase, the benefits of the optionee; provided, however, that subject to any required action by the shareholders, if the Company shall not be the surviving corporation in any merger, consolidation or reorganization, every option outstanding hereunder shall terminate, unless the surviving corporation shall (subject to applicable provisions of the Internal Revenue Code) substitute a new option therefor or assume (with appropriate changes) the existing option. If the option shall terminate by reason of such merger, consolidation or reorganization, then, notwithstanding the option period, the option may be exercised, in whole or in part, by the optionee at any time prior to or concurrently with consummation of such merger, consolidation or reorganization. The Committee may include in the Stock Option Agreement more detailed provisions with respect to such adjustments.

(d) *Consideration for Option.* In consideration of the granting of the option, the optionee shall agree (i) to remain in the employ of the Company or an affiliate for a period of at least 1 year after the option is granted, subject to the right of the Company or such affiliate to terminate his employment at any time for any reason whatsoever, (ii) that during the lifetime of the optionee the option shall be exercisable only by the optionee and shall not be transferable except by will or the laws of descent and distribution, and (iii) in the discretion of the Committee, that such optionee, and each person who shall exercise such option, shall represent that any and all shares purchased pursuant to such option will be purchased for investment and not with a view to the distribution or resale thereof.

(e) *Other Provisions.* The option may contain such other terms, provisions and conditions not inconsistent with the Plan as may be determined by the Committee and shall include such provisions and conditions as may be necessary to qualify the option as a "qualified stock option" under Section 422 of the Internal Revenue Code as now in effect or as hereafter amended from time to time.

5. *Proceeds from Sale of Stock.*

Proceeds from the sale of stock pursuant to the options granted under the Plan shall be added to the general funds of the Company.

6. *Suspension or Termination of the Plan.*

The Board of Directors may at any time suspend or terminate the Plan. Unless the Plan shall theretofore have been terminated by the Board of Directors, the Plan shall terminate on December 31, 1975. No option may be granted during such suspension, or after such termination. The termination of the Plan shall not, without the consent of the optionee, alter or impair any rights or obligations under any option theretofore granted under the Plan.

Dated: March 5, 1968.

THIS IS EXHIBIT 1 to the Listing Application of RESERVE OIL AND GAS COMPANY dated the 14th day of June, 1968.

List of Common Stock Issued by

RESERVE OIL AND GAS COMPANY

March 16, 1932 — June 10, 1968

NUMBER OF SHARES	DATE	PURPOSE	RUNNING TOTAL
10,000	1932	Original Issue (Cash)	10,000
90,000	1933	Recapitalization 10/1 Exchange	100,000
6,711	July 1936	Offering to Shareholders (Cash)	106,711
6,789	Aug. 1936	Offering to Shareholders (Cash)	113,500
20,000	Oct. 1936	Conversion of promissory notes	133,500
328	Dec. 1936	Offering to Shareholders (Cash)	133,828
6,037	Jan. 1937	Offering to Shareholders (Cash)	139,865
5,000	1938	Cancellation of contractual obligation	144,865
5,400	1939	Conversion of promissory notes	150,265
5,000	1939	Assignment of Oil Lease	155,265
2,000	1944	Conversion of promissory notes	157,265
575	Feb. 2, 1945	Cancellation of indebtedness	157,840
21,900	1945	Conversion of promissory notes	179,740
700	May 1945	Sold for cash	180,440
1,500	May 1945	For services	181,940
26,696	May 16, 1945	Cancellation of indebtedness	208,636
16,364	Nov. 14, 1945	Sold for cash	225,000
15,000	May 25, 1946	Sold for cash	240,000
10,000	Dec. 6, 1948	Sold for cash	250,000
250,000	May 1951	Stock split (no sale)	500,000
10,000	Jan. 1954	Stock dividend (no sale)	510,000
10,200	June 1954	Stock dividend (no sale)	520,200
5,540	1954	Options exercised	525,740
10,514	Feb. 1955	Stock dividend (no sale)	536,254
10,756	July 1955	Stock dividend (no sale)	547,010
3,238	1955	Options exercised	550,248
500,248	Feb. 1956	Stock split (no sale)	1,100,496
22,009	Mar. 1956	Stock dividend (no sale)	1,122,505
22,492	Oct. 1956	Stock dividend (no sale)	1,144,997
12,801	1956	Options exercised	1,157,798
23,156	Apr. 1957	Stock dividend (no sale)	1,180,954
916	1957	Options exercised	1,181,870
34,359	Feb. 1958	Stock dividend (no sale)	1,216,229
1,500	1958	Options exercised	1,217,729
23,484	Feb. 1959	Stock dividend (no sale)	1,241,213
1,500	1959	Options exercised	1,242,713
3,975	1959	Options exercised	1,246,688
24,021	Feb. 1960	Stock dividend (no sale)	1,270,709
24,446	Feb. 1961	Stock dividend (no sale)	1,295,155
1,000	1961	Options exercised	1,296,155
1,000	1962	Options exercised	1,297,155
172,640	Apr. 27, 1964	Acquisition of Fremont Valley Properties	1,469,795
215,000	May 24, 1965	Acquisition of Rice Ranch Properties	1,684,795
338,028	Mar. 31, 1966	Acquisition of Long Beach Properties	2,022,823
2,500,326	Apr. 29, 1966	Acquisition of Apple Valley Properties	4,523,149
13,267	Aug. 1967 to June 10, 1968	Conversion of preferred shares, Series A	4,536,416
3,432	Aug. 1967 to June 10, 1968	Conversion of preferred shares, Series B	4,539,848
8,350	Jan. 1968 to June 10, 1968	Options exercised under the Selected Employees' Stock Option Plan—1964	4,548,198
103,601	Jan. 1968	Conversion of Debentures	4,651,799
55,985	Feb. 1968	Conversion of Debentures	4,707,784
3,424	Mar. 1968	Conversion of Debentures	4,711,208
2,668,257	June 10, 1968	Exchange for the shares of Fargo Oils Ltd.	7,379,465
7,379,465	ISSUED		

THIS IS EXHIBIT 2 to the Listing Application of RESERVE OIL AND GAS COMPANY dated the 14th day of June, 1968.

EXERCISE OF RESERVE STOCK OPTIONS

1-1-54 THROUGH 6-10-68

	NO. OF COMMON SHARES	PRICE PER SHARE	TOTAL CONSIDERATION
<u>1954</u>	1,000	\$13.0143	\$ 13,014
	1,040	21.0096	21,850
	2,500	13.0142	32,535
	1,000	21.0015	21,001
Total	<u>5,540</u>		<u>\$ 88,400</u>
<u>1955</u>	1,572	\$18.3774	\$ 28,889
	1,666	20.1822	33,624
Total	<u>3,238</u>		<u>\$ 62,513</u>
<u>1956</u>	2,100	\$10.0800	\$ 21,168
	9,315	6.0200	56,076
	898	8.6800	7,795
	488	8.6700	4,231
Total	<u>12,801</u>		<u>\$ 89,270</u>
<u>1957</u>	916	\$ 8.5100	\$ 7,795
Total	<u>916</u>		<u>\$ 7,795</u>
<u>1958</u>	500	\$17.9300	\$ 8,965
	1,000	17.9200	17,920
Total	<u>1,500</u>		<u>\$ 26,885</u>
<u>1959</u>	500	\$20.2300	\$ 10,115
	1,000	23.8000	23,800
	472	15.1600	7,155
	3,503	9.2200	32,298
Total	<u>5,475</u>		<u>\$ 73,368</u>
<u>1961</u>	1,000	\$12.3500	\$ 12,350
Total	<u>1,000</u>		<u>\$ 12,350</u>
<u>1962</u>	1,000	\$12.3500	\$ 12,350
Total	<u>1,000</u>		<u>\$ 12,350</u>
<u>1968 (to 6-10)</u>	8,350	\$ 6.8750	\$ 57,406
Total	<u>8,350</u>		<u>\$ 57,406</u>
GRAND TOTALS:	<u>39,820</u>		<u>\$430,337</u>

FINANCIAL STATEMENTS

RESERVE OIL AND GAS COMPANY

BALANCE SHEET

March 31, 1968

(UNAUDITED)

ASSETS

CURRENT ASSETS

Cash, Including C.D.'s \$2,315,000	\$ 3,903,608
Accounts Receivable	1,575,415
Notes Receivable	340,619
Installment Contracts Receivable	638,500
Commissions Receivable	1,162,800
Inventories	
Anhydrous Ammonia, at market	335,476
Crude Oil, at market	76,138
Materials and Supplies, at average cost	241,629
Subdivided Land, at cost	71,236
Other	314,840
Prepaid Expenses and Deferred Charges	630,550
	<u>9,290,811</u>

INVESTMENTS AND LONG-TERM RECEIVABLES

Notes Receivable	397,857
Installment Contracts Receivable — net	3,829,040
Commissions Receivable	3,316,708
Investment in Fargo Oils Ltd. and A.V.R. Water Co.	11,466,005
Undeveloped Land — cost	928,612
	<u>19,938,222</u>

PROPERTIES

Oil and Gas Properties	45,161,546
Less: Outstanding Balance of Reserved Production Payments	12,155,281
Oil and Gas Properties — cost	33,026,265
Commercial and Other Properties — cost	4,829,740
	<u>37,836,005</u>
Less: Accumulated Depletion and Depreciation	21,444,196
	<u>16,391,809</u>

DEFERRED CHARGE, UNAMORTIZED DEBT EXPENSE	437,294
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TOTAL ASSETS	<u>\$46,058,136</u>
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LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES

Notes Payable	\$ 125,667
Accounts Payable and Accrued Liabilities	1,823,160
Commissions Payable	110,000
Construction Costs Payable	329,388
	2,388,215

LONG-TERM LIABILITIES

6½ % Convertible Subordinated Debentures	11,860,000
Notes payable and Other Long-Term Debt	515,859
Commissions Payable	108,528
Deferred Federal and State Income Taxes	4,352,922
	16,837,309

DEFERRED INCOME — SALES AGENCY CONTRACTS	2,379,586
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SHAREHOLDERS' EQUITY

Capital Stock

Preferred, \$25. par value

Shares Authorized	400,000	
Series "A", 5½ %, issued and outstanding	27,122	678,050
Series "B", 5½ %, issued, incl. 2,435 shs. in Treasury	107,338	2,683,450

Common, \$1. par value

Shares Authorized	15,000,000	
Shares Reserved for Options	73,250	
Shares Reserved for Conversion of Pfd. Stock and Debentures	1,239,237	
Issued, incl. 20,387 shs. in Treasury	4,708,959	4,708,959

Capital Surplus	4,676,616
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Earned Surplus

Balance, December 31, 1967	\$11,617,692	
Cash Dividends — Preferred Stock	(45,376)	
Net Income, before Federal Income Tax, three months ended March 31, 1968	219,618	11,791,934
		24,539,009

Less Treasury Stock, at cost (2,435 shs. Series "B" Pfd. and 20,387 shs. Common)	85,983
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Total Shareholders' Equity	24,453,026
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TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$46,058,136
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NEWTON T. BASS, *Director*

W. E. CRAMER, JR., *Director*

RESERVE OIL AND GAS COMPANY

STATEMENT OF INCOME

Three Months Ended March 31, 1968

(UNAUDITED)

REVENUES:

Sales of petroleum products	\$1,836,173
Sales of real estate	198,450
Commission income	399,228
Other income — including interest, \$116,609	218,183
	2,652,034

COSTS AND EXPENSES:

Oil and gas and other operating expenses	909,966
Cost of real estate sold and loss on repossessions	137,191
Selling and administrative expenses	414,748
Dry hole costs	812
Depletion, depreciation and abandonments	614,329
Interest expense	355,370
Federal income taxes	25,000
	2,457,416

INCOME BEFORE EXTRAORDINARY ITEM	194,618
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EXTRAORDINARY ITEM —

Federal income tax reduction attributable to loss carryforwards	25,000
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NET INCOME	<u>\$ 219,618</u>
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PER SHARE OF COMMON STOCK:

Income before extraordinary item	\$.03
Extraordinary item	.01
Net income applicable to common stock	<u>\$.04</u>

